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OVERSIGHT OF GOVERNMENT MERGER ENFORCEMENT POLICY

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

OVERSIGHT OF GOVERNMENT MERGER ENFORCEMENT POLICY

OCTOBER 27 AND NOVEMBER 19, 1981

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OVERSIGHT OF GOVERNMENT MERGER ENFORCEMENT POLICY

TUESDAY, OCTOBER 27, 1981

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The committee met, pursuant to notice, at 2:35 p.m., in room 2228, Dirksen Senate Office Building, Senator Arlen Specter (acting chairman of the committee) presiding.

Also present: Senators Kennedy, Metzenbaum, and Leahy.

Staff present: Quentin Crommelin, Jr., staff director; Steve Cannon, antitrust counsel; Bruce A. Cohen, counsel; and Mary Louise Westmoreland, counsel.

OPENING STATEMENT OF SENATOR ARLEN SPECTER

Senator SPECTER. The hearing will come to order.

We regret the delay in opening the hearing but the Senate had a vote scheduled at 2 o'clock, and the chairman of the Judiciary Committee scheduled a special session of the committee to act on certain nominations at 2:15. These events prevented our arriving here until this moment. We express our regrets to all of you who have been here for the past 30 minutes.

This hearing this afternoon will focus on Government merger enforcement policy. It is held pursuant to the oversight responsibilities of the Committee on the Judiciary regarding the antitrust laws.

Since early this year we have witnessed a tremendous increase in the number of mergers involving sums of money which can only be described as astronomical. Mergers like the Du Pont acquisition of Conoco have captured the attention of the entire Nation. While numerous industries have participated in this merger activity, it would appear that the natural resource and financial industries have been particularly active.

As is the case with other members of this committee, I personally am curious to learn why merger activity has suddenly and dramatically increased. Numerous theories have been advanced. There are those who believe these mergers are simply a function of the state of the economy. Others have noted the cyclical nature of mergers, pointing out the merger wave of the early 1960's. Finally, there are those who would attribute the current merger activities to the antitrust policy of President Reagan's new administration.

Some critics have charged that the administration has not been sufficiently vigorous in the enforcement of antitrust policy. Others

have contended that the new policy is an appropriate response to the economic realities of this year.

One purpose this afternoon is to eliminate, as much as possible, any perceived uncertainty regarding merger enforcement policy. Among our witnesses today we are pleased to have the two principal officials responsible for enforcing our antitrust laws, William F. Baxter, Assistant Attorney General in charge of the Antitrust Division of the Justice Department, and James C. Miller III, the new Chairman of the Federal Trade Commission.

We welcome you here again, Mr. Baxter, and would be very pleased to hear your opening statement.

Senator KENNEDY. Mr. Chairman, could we make a brief comment at the outset of the hearing?

Senator SPECTER. Pardon me. Yes. Before proceeding with Mr. Baxter's testimony, if there are opening statements from Senator Kennedy, Senator Metzenbaum, and Senator Leahy, we will proceed with them at this time.

OPENING STATEMENT OF SENATOR EDWARD M. KENNEDY

Senator KENNEDY. Thank you very much, Mr. Chairman.

I want to express my appreciation to you and the chairman of the committee for holding these extremely important hearings which I think are of great interest to the American people, when we realize that the economy is still the number one issue, the number one concern for the American people. I think the issue of competitiveness and what this administration's position is going to be on competitiveness in our society is of great significance and importance.

Today the committee looks at the antitrust policy of the Reagan administration, particularly in respect to mergers. This oversight is timely and important for the American consumer and for the small businessmen and women throughout our country. Reasonable men and women differ over antitrust theory, and inevitably every administration shapes its own policies and priorities for enforcement.

When storm signals mount that our antitrust enforcement agencies may disregard the laws passed by Congress and the Supreme Court decisions under those laws because the Assistant Attorney General for Antitrust and the Chair of the FTC disagree with Congress and the court, it is time for this committee to get an explanation. We all know that antitrust laws and theories often seem complex and academic to the average citizen but I believe that the consumers and small businessmen and women of America understand the basic principle of antitrust: When competition is foreclosed or conducted unfairly, they suffer.

Antitrust enforcement is especially crucial now. As we increase deregulation of industry, we increase our reliance on a competitive free market to protect the public interest. While inflation continues to plague us, removing artificial restraints on price competition remains an important part of any anti-inflation program. Above all, when the administration disagrees with the laws on the books or with the clear line of Supreme Court precedent interpreting them, the proper course under our system is to ask Congress to

change the law. Agency heads should not arrogate to themselves the right to nullify our antitrust laws by refusing to enforce them.

Therefore, today we will be questioning Mr. Baxter and Mr. Miller about their present policy and their plans for antitrust enforcement. A major concern is their apparent disdain for a Government challenge to vertical mergers or vertical restraints of trade between manufacturers and their suppliers or distributors. There Congress and the Supreme Court have made amply clear that this is an important area of antitrust violations under the law. Mr. Baxter and Mr. Miller have an obligation to follow the law.

Another major concern is the FTC's budget proposals for the next few years. They are starvation budgets for many of the commission's most important programs of consumer protection from fraud and antitrust. They will not only cut out any fat but also cut into muscle and bone.

These and other concerns are not partisan issues. Senators Danforth and Gorton, both vigorous State attorneys general before coming to the Senate, and other Senators of both parties have expressed their dismay at the danger that antitrust will be sharply cut back in this administration.

This hearing marks the beginning of a new round of antitrust oversight by this committee. I commend the chairman for agreeing to schedule it, and look forward to the full cooperation of the executive branch as we perform our constitutional duties. I have long been a supporter of the free market and of an end to unnecessary regulation but we must make sure, through strong antitrust enforcement, that the market is in fact a free and competitive one.

I thank the Chair.

OPENING STATMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. Mr. Chairman, I would like to commend you for scheduling this hearing and taking the time to do so, and for your interest in the subject. I think that there is no more important subject that we have before us in the Congress because to me the free enterprise system rests very much on the opportunity for competition to exist in the system.

When the free enterprise system finds that competitive forces are no longer able to work, then it will no longer be an operable part of the capitalist system and we will probably have some other kind of system. That I think would be obviously intolerable, and I think it is intolerable that we are moving to abandon our obligation to obey the law.

In our concern about law and order, we have much emphasis these days on the question of crime in the streets and white collar crime. But the fact is, one has to raise a question of the legality of the behavior of the chief official charged with the enforcement of our laws in the field of antitrust but totally abrogating the responsibility to follow the law in that respect.

As a consequence, the merger movement continues to swell. Just last week it was reported in the Wall Street Journal that the merger pace jumped again in the third quarter, 25 percent over last year. These are not small, inefficient companies that are being swallowed up. This is not a question of a giant coming in and help-

ing a small company that has gotten into trouble and needs some capital support. The merger targets include the giants of American business, profitable, growing companies like Conoco, St. Joe Minerals, Salomon Bro., and so many others.

These mergers threaten to concentrate American business even more than it is now. They involve a gross misuse of scarce capital. We are told that we must promote supply-side economics; we must be able to provide the funding so that business may expand, so that business may provide the new technology to resist the invasion of our foreign competitors. Then we find that those very same companies are raising billions of dollars for the purpose of acquiring other companies which add nothing to the economy.

The oil industry alone will probably need $1 trillion in the next decade to help solve our energy problem, and will have to go to the credit markets. However, that did not stop Mobil from arranging a $6 billion loan to try to buy Conoco, or Exxon from spending over $1 billion to buy Reliance Electric, a deal, incidentally, that turned out to be a fiasco.

While we in the Budget Committee were talking about the fact that there might be available a total of something like $18 or $19 billion in the credit market for all of American business this year, we found that almost overnight those industries that were determined to buy up Du Pont and other companies as well had gone to the credit market and picked up more than that $18 or $19 billion.

The country needs more investment in productivity and innovation. However, shortrun-oriented corporate managers are concentrating on safe empire building. How does it affect the P. & L. if we buy the company? What can we do with the price-earnings ratio? What kind of leverage can be provided? Sometimes that increases earnings but it ultimately does little for the shareholder or for the economy.

To all of this our antitrust agencies have become benignly indifferent. There were a few signs of life when the Antitrust Division vetoed the Schlitz-Heileman merger last week and the FTC, apparently without Mr. Miller, voted to challenge the LTV-Grumman merger. However, it is quite obvious that those are very isolated events, and are dwarfed by the continuous flow of signals from Washington that now practically anything goes.

Clear and never overruled Supreme Court decisions are ignored and disdained by officials sworn to uphold and enforce the law. The social and political aspects of our antitrust laws, the central part of the antitrust tradition, are scorned. FTC regional offices are being closed and an extremely narrow view of the FTC's role in enforcing the law has been adopted.

As a matter of fact, the reality of the situation in this administration at the moment—and it is not only in the Antitrust Department and the FTC but also in the Department of Energy, the Interior Department, the EPA—is that people are being put in to run the departments who really would like to eliminate those departments entirely and eliminate the laws that support those departments. There is a real question of the whole integrity of the governmental process if people are put into place to run a department or to enforce laws and feel no obligation to do so, but rather to negate entirely the reason for those departments to exist.

The Supreme Court has fully implemented Congress bipartisan purpose in wanting to halt these massive merger movements but our new antitrust authorities do not like those cases. Rubbish is one of Mr. Baxter's milder comments. A few months ago he proclaimed: "There is a thriving portion of antitrust law that purports to find evil in purely vertical arrangements. I find that approach fundamentally misguided." That was in August 1981 from Dun's Review.

The FTC transition team, headed by now-FTC Chairman Miller, wrote: "A decision to take issue with a particular business practice transcends the issue of legality." Now the dictionary defines transcends as rising above. Imagine! Now it is not enough that a practice is illegal: The enforcement decision rises above mere legality!

When you have decisions of that kind and comments of that kind from people who are charged with enforcing the law, how do you expect the average citizen in America to live up to the provisions of the law? Maybe it is OK for an American Enterprise Institute or some other kind of scholar to talk about transcending the law, but it hardly seems the right approach for the Nation's chief law enforcement officers or an administration so thoroughly committed, according to its words, to law and order, a commitment that its actions seem to belie.

It is particularly disturbing and surprising that this antitrust attitude should be taken by a Republican administration. Until now, few aspects of American life and law have had such bipartisan support as has antitrust. Senator John Sherman, a great Republican Senator from my own State, authored the basic law which bears his name. It was signed into law by a Republican President. The Clayton Act was the product of the Wilson administration. The Senate Antitrust Subcommittee was revived by a Republican-controlled Senate in 1953, and last year's Antitrust Improvements Act was a joint product of Senator Thurmond and myself.

Vigorous enforcement has come under both Republicans and Democrats. The FTC was given new life and vigor by Republicans in 1970, and much of its recent activity was initiated by Republican chairmen.

Now that great American tradition is being undermined by unilateral administrative rewriting of the law.

As Senator Slade Gorton, true to the bipartisan tradition in antitrust, put it a few weeks ago: "It is improper for the administration to announce a tolerance policy for certain types of law violations and thus, in effect, amend legislation by fiat."

In keeping with the bipartisan concern for antitrust enforcement, I would like also to note Senator Danforth's concern on the floor of the Senate last month. He deplored what he called a lack of resolve on the part of the administration to uphold antitrust enforcement.

For all these reasons, Mr. Chairman, I am pleased that we will finally have an opportunity to explore these very disturbing developments with the officials who are directly responsible for them.

Senator SPECTER. Senator Leahy?

OPENING STATEMENT OF SENATOR PATRICK J. LEAHY

Senator LEAHY. Thank you, Mr. Chairman.

Mr. Chairman, I too want to commend you for holding these hearings at a time when a lot of us are concerned that the former Antitrust Subcommittee has disappeared, and a time when a great deal of merger operations are going on in the country, at a time when much of the capital market is being dried up because of that. I think the fact that you are holding hearings and the fact that you are willing to hold those hearings gives a lot of people a great deal of comfort.

You know, I have always been intrigued with the ironies that underlie much of what goes on in Government. The recent policy pronouncements of the administration on mergers, well, those present many opportunities to be intrigued.

This Congress has been working hard on legislation to stop the concentration of governmental power and to widen the authority to make decisions. At the same time, the antitrust policies of this administration seem to be designed to concentrate industry and replace narrow and topheavy Government decisionmaking with narrow and topheavy industry decisionmaking. Now I will concede the final ending really has not been written to these policies but I worry about the early trends.

Let me just mention a couple of the signs: virtual abandonment of certain areas of enforcement, such as vertical mergers and resale price maintenance; the dropping of antitrust cases inherited from previous administrations; repeated pronouncements that set an unmistakable tone, like bigness is not bad; and switching the Government's role in private antitrust suits by promising to support defendants with amicus briefs rather than plaintiffs.

Now these are a few obvious signs but I also see the outlines of a policy that defines antitrust narrowly to mean only the threat to competition in a specific market, even if that policy means all but a few competitors will disappear from the marketplace, and even if the trend to merge is going to create an intense concentration of capital.

The American democracy works for some reasons that are clear and are grounded in the Constitution, and for other reasons that are less clear and are founded in social traditions and economic patterns that are as much a part of what we are as is the Bill of Rights. If it would be excessively rosy to suggest that we have corporate democracy in America, it is no exaggeration to say that the decisions made by the marketplace are protected from errors and rash extremes because of the great diversity of corporate managers making those decisions. I would find it hard to believe that a few centralized corporate decisionmakers would do as well, or would be an improvement over the few Government agency decisionmakers whose power we are trying so hard to curtail and assign to a broader constituency.

It is also safe to conclude that there is little administration interest in vertical mergers, while horizontal mergers will be weighed against a wide variety of factors in addition to those in the present merger guidelines. I am afraid we are going to end up with a policy so broad and so general and so replete with qualifications that it

will be no policy at all, but rather a summary of current economic theory about corporate mergers.

Now that does not give an awful lot of guidelines for prosecutors, and it does not give an awful lot of guidelines for the private sector. Therefore, I would like to hear the thoughts of the administration on the recent trends in conglomerate mergers. I intend, if there is any part of this meeting that I have to miss, to be reading the transcript of what they do say because there is considerable agreement that many of these mergers have no immediate, significant impact on competition, but this is far from justifying a conclusion that an accelerating trend to conglomerate mergers will not affect the fabric of life in the country. While the potential competition theory has not been widely used in the recent past because of difficulties of proof in that theory, the area is important and should have some key analysis from the Justice Department and the FTC.

I have been talking about some of the areas of substance rather than process, the merger issues rather than the means by which new policies devolve. I want to add that the process disturbs me even more than the policy changes I have been able to discern so far.

Traditionally, enforcement priorities at the Justice Department and the FTC are matters within the sound discretion of the President's appointees, the Attorney General and the Chairman of the FTC. Enforcement priorities reflect the application of scarce resources to an order of priorities where all the enforcement goals under law cannot be achieved or cannot be achieved at one time.

However, I wonder if prosecutorial discretion is not being used at the present time to effectively amend statutes, in other words, doing by prosecutorial discretion, however vaguely defined, those things that are normally left to the Congress itself—amending statutes whose goals are deemed archaic or out of step with currently popular economic analyses. I might say those who were able to tout some of the economic ideas and plans earlier this year when they were very popular are the ones who are now very concerned about the fast-declining popularity of those theories.

The legislative history of the amendment of section 7 of the Clayton Act of 1950 reflects that Congress was concerned with more than the protection of competition, though that was the primary goal. Congress was clearly concerned with the disappearance of small enterprise, small businesses, in favor of a few dominant giants with a progressive concentration in capital.

The Supreme Court in the fifties and sixties made it clear that they looked beyond strict economic considerations. Thirty years of fairly consistent interpretation should not be cast aside in the name of arranging priorities, which should be changed only after serious consideration both by the enforcement agencies involved and the Congress.

The independent agencies have always served as a protection against precipitant action by any administration. Merger policies can affect the health and dimension of the business sector for generations, so I would hope that these changes—changes which a number of us find quite troubling—will not be precipitous.

Mr. Chairman, I ask that my full statement be made a part of the record.

Senator SPECTER. Without objection, so ordered.

[Prepared statement of Senator Leahy follows:]

PREPARED STATEMENT OF SENATOR PATRICK J. LEAHY

I HAVE ALWAYS BEEN INTRIGUED WITH THE IRONIES THAT UNDERLIE MUCH OF WHAT GOES ON WITHIN GOVERNMENT, AND THE RECENT POLICY PRONOUNCEMENTS OF THE ADMINISTRATION ON MERGERS PRESENT MANY OPPORTUNITIES TO BE INTRIGUED. WHILE THIS CONGRESS HAS BEEN WORKING HARD ON LEGISLATION TO DECONCENTRATE GOVERNMENTAL POWER AND TO WIDEN THE AUTHORITY TO MAKE DECISIONS, THE ANTITRUST POLICIES OF THIS ADMINISTRATION SEEM DESIGNED TO RECONCENTRATE INDUSTRY AND REPLACE NARROW AND TOP-HEAVY GOVERNMENT DECISIONMAKING WITH NARROW AND TOP-HEAVY INDUSTRY DECISIONMAKING.

I WILL CONCEDE THAT THE FINAL ENDING HAS NOT BEEN WRITTEN TO THE ADMINISTRATION'S MERGER POLICIES, BUT I WORRY ABOUT THE EARLY TRENDS. HERE ARE A FEW OF THE SIGNS I SEE:

- VIRTUAL ABANDONMENT OF CERTAIN AREAS OF ENFORCEMENT, SUCH AS VERTICAL MERGERS AND RESALE PRICE MAINTENANCE.
- THE DROPPING OF ANTITRUST CASES INHERITED FROM PREVIOUS ADMINISTRATIONS.
- REPEATED PRONOUNCEMENTS THAT SET AN UNMISTAKABLE TONE, LIKE "BIGNESS IS NOT BAD."
- SWITCHING THE GOVERNMENT'S ROLE IN PRIVATE ANTITRUST SUITS BY PROMISING TO SUPPORT DEFENDANTS WITH AMICUS BRIEFS RATHER THAN PLAINTIFFS.

THESE ARE A FEW OBVIOUS SIGNS. I ALSO SEE THE OUTLINES OF A POLICY THAT DEFINES HARM NARROWLY TO MEAN ONLY THE THREAT OF IMPAIRMENT TO COMPETITION IN A SPECIFIC MARKET, EVEN IF THAT POLICY MEANS ALL BUT A FEW COMPETITORS WILL DISAPPEAR FROM THE MARKETPLACE AND EVEN IF THE TREND TO MERGE WILL CREATE AN INTENSE CONCENTRATION OF CAPITAL.

THE AMERICAN DEMOCRACY WORKS FOR SOME REASONS THAT ARE CLEAR AND ARE GROUNDED IN THE CONSTITUTION AND FOR OTHER REASONS THAT ARE LESS CLEAR AND ARE FOUNDED IN SOCIAL TRADITIONS AND ECONOMIC PATTERNS THAT ARE AS MUCH A PART OF WHAT WE ARE AS THE BILL OF RIGHTS. IF IT WOULD BE EXCESSIVELY ROSY TO SUGGEST THAT WE HAVE CORPORATE DEMOCRACY IN AMERICA, IT IS NO EXAGGERATION TO SAY THAT THE DECISIONS MADE BY THE MARKETPLACE ARE PROTECTED FROM ERRORS AND RASH EXTREMES BECAUSE OF THE GREAT NUMBER AND DIVERSITY OF CORPORATE MANAGERS MAKING THOSE DECISIONS. I WOULD FIND IT HARD TO BELIEVE THAT A FEW CENTRALIZED CORPORATE DECISIONMAKERS WOULD DO AS WELL OR WOULD BE AN IMPROVEMENT OVER THE FEW GOVERNMENT AGENCY DECISIONMAKERS

WHOSE POWER WE ARE TRYING SO HARD TO CURTAIL AND REASSIGN TO A BROADER CONSTITUENCY.

IT IS SAFE TO CONCLUDE THAT THERE IS LITTLE ADMINISTRATION INTEREST IN VERTICAL MERGERS, WHILE HORIZONTAL MERGERS WILL BE WEIGHED AGAINST A WIDE VARIETY OF FACTORS IN ADDITION TO THOSE IN THE PRESENT MERGER GUIDELINES.

I AM WORRIED THAT IN AN EFFORT TO ESCAPE FROM THE PERCEIVED TYRRANY OF ARBITRARY NUMBERS IN THE MERGER GUIDELINES, WHAT WILL EMERGE IS A POLICY THAT IS SO BROAD, SO GENERAL, AND SO REPLETE WITH QUALIFICATIONS THAT IT WILL BE NO POLICY AT ALL,BUT RATHER A SUMMARY OF CURRENT ECONOMIC THEORY ABOUT CORPORATE MERGERS. THIS SORT OF DOCUMENT CAN PROVIDE LITTLE CONSISTENCY FOR PROSECUTORS AND EVEN LESS GUIDANCE FOR THE PRIVATE SECTOR.

ENFORCEMENT GUIDELINES AT THEIR VERY BEST SERVE A DISTINCT BUT LIMITED PURPOSE. THEY SIGNAL A NEED TO EXAMINE AND PERHAPS A NEED TO ACT. THEY HAVE NEVER PURPORTED TO BE A SUBSTITUTE FOR A REASONED DECISION TO PROCEED IN COURT -- OR NOT-- AND WERE NEVER MEANT TO BE CONFUSED WITH JUDICIAL DETERMINATIONS. THEY ARE DESIGNED TO BE ROUGH ROAD MAPS FOR THOSE WHO MUST ENFORCE THE LAW AND THOSE WHO WANT A GOOD BUT ESSENTIALLY SIMPLE RULE OF THUMB TO GUIDE FURTHER ANALYSIS. ANY GUIDELINE IS RIGID AND SIMPLISTIC BECAUSE IT IS A GUIDELINE. OTHERWISE, IT IS A TREATISE OF AN OPINION.

I HOPE THAT IN REVISING THE GUIDELINES, THE JUSTICE DEPARTMENT DOES NOT DICTATE THAT ALL FIRM POLICY GUIDANCE FROM THE FEDERAL GOVERNMENT MUST WITHER AND THERBY ALLOW MERGER COUNSEL TO ARGUE, WITH GREATER TRUTH THAN EVER, THAT THEY DID NOT KNOW THAT THEIR CLIENTS' PROPOSALS CONTRAVENED SETTLED INTERPRETATIONS OF THE LAW.

I AM EAGER TO HEAR THE THOUGHTS OF THE ADMINISTRATION ON THE RECENT TRENDS IN CONGLOMERATE MERGERS. THERE IS CONSIDERABLE AGREEMENT THAT MANY OF THESE MERGERS HAVE NO IMMEDIATE, SIGNIFICANT IMPACT ON COMPETITION. BUT THIS IS FAR FROM JUSTIFYING A CONCLUSION THAT AN ACCELERATING TREND TO CONGLOMERATE MERGERS WILL NOT AFFECT THE FABRIC OF LIFE IN THE COUNTRY. WHILE THE POTENTIAL COMPETITION THEORY HAS NOT BEEN WIDELY USED IN THE RECENT PAST BECAUSE OF DIFFICULTIES OF PROOF INHERENT IN THE THEORY, THE AREA IS IMPORTANT AND WOULD BENEFIT FROM KEEN ANALYSIS IN THE JUSTICE DEPARTMENT AND AT THE FTC.

AT THE INSTITUTIONAL LEVEL, I AM WORRIED ABOUT THE FUTURE OF THE FEDERAL TRADE COMMISSION WHOSE BUDGET FOR FY 82 HAS BEEN CUT 12 PERCENT, WHICH WILL RESULT IN SHARP CUTS IN THE AGENCY'S WORK FORCE AND THE CLOSING OF FOUR OF THE TEN REGIONAL OFFICES. ULTIMATELY

THE FY 84 BUDGET RECOMMENDATION OF 81.7 MILLION BY THE PREVIOUS ADMINISTRATION IS SLATED TO BE REDUCED TO 53.8 MILLION, A CUT APPROVED BY CHAIRMAN MILLER.

WHILE I RESPECT THE WISHES OF THE CHAIRMAN TO INCREASE THE ECONOMIC ANALYSIS ACTIVITY OF THE FTC, IF THE AGENCY'S BUDGET IS BEING SHARPLY CURTAILED AND THOSE CUTS ARE ACCENTUATED BY INFLATION, THE CURRENT LEVEL OF ENFORCEMENT ACTIVITY IS BOUND TO DECLINE, EVEN WIHTOUT ADDING ANY NEW FUNCTIONS.

SO FAR I HAVE BEEN SPEAKING OF SUBSTANCE RATHER THAN PROCESS, THE MERGER ISSUES RATHER THAN THE MEANS BY WHICH NEW POLICIES EVOLVE. BUT I MUST ADD THAT THE PROCESS DISTURBS ME EVEN MORE THAN THE POLICY CHANGES I HAVE BEEN ABLE TO DISCERN SO FAR. TRADITIONALLY, ENFORCEMENT PRIORITIES AT THE JUSTICE DEPARTMENT AND THE FTC ARE MATTERS WITHIN THE SOUND DISCRETION OF THE PRESIDENT'S APPOINTEES, THE ATTORNEY GENERAL AND THE CHAIRMAN OF THE FTC. ENFORCEMENT PRIORITIES REFLECT THE APPLICATION OF SCARCE RESOURCES TO AN ORDER OF PRIORITIES, WHERE ALL OF THE ENFORCEMENT GOALS UNDER LAW CANNOT BE ACHIEVED OR CANNOT BE ACHIEVED AT ONE TIME.

BUT I WONDER IF PROSECUTORIAL DISCRETION IS NOT BEING USED AT THE PRESENT TIME TO EFFECTIVELY AMEND STATUTES WHOSE GOALS ARE DEEMED ARCHAIC OR OUT OF STEP WITH CURRENTLY POPULAR ECONOMIC ANALYSIS. THE LEGISLATIVE HISTORY OF THE AMENDMENT OF SECTION 7 OF THE CLAYTON ACT IN 1950 REFLECTS THAT CONGRESS WAS CONCERNED WITH MORE THAN THE PROTECTION OF COMPETITION, THOUGH THAT WAS THE PRIMARY GOAL. CONGRESS WAS CLEARLY CONCERNED WITH THE DISAPPEARANCE OF SMALL ENTERPRISE IN FAVOR OF A FEW DOMINANT GIANTS AND WITH THE PROGRESSIVE CONCENTRATION OF CAPITAL. THE SUPREME COURT IN THE 1950'S AND 1960'S MADE IT CLEAR THAT IT LOOKED BEYOND STRICT ECONOMIC CONSIDERATIONS TO THE THREAT OF CONCENTRATION IN EVALUATING A NUMBER OF HORIZONTAL MERGERS.

THIRTY YEARS OF FAIRLY CONSISTENT INTERPRETATIONS SHOULD NOT BE CAST ASIDE IN THE NAME OF ARRANGING PRIORITIES, BUT SHOULD BE CHANGED ONLY AFTER SERIOUS CONSIDERATION BOTH BY THE ENFORCEMENT AGENCIES INVOLVED AND THE CONGRESS.

THE INDEPENDENT AGENCIES HAVE ALWAYS SERVED AS A PROTECTION AGAINST PRECIPITATE ACTION BY ANY GIVEN ADMINISTRATION, AND I THINK IT DEMEANS NO ONE TO URGE THAT POLICY CHANGES AT THE FTC BE UNDERTAKEN WITH DELIBERATION AND ONLY AFTER CONSULTATION WITH CONGRESS.

MERGER POLICIES CAN AFFECT THE HEALTH AND DIMENSION OF THE BUSINESS SECTOR FOR GENERATIONS. THEY SURELY DESERVE THE ATTENTION OF ALL TODAY.

Senator SPECTER. Mr. Baxter, the floor is yours.

STATEMENT OF WILLIAM F. BAXTER, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. BAXTER. Thank you, Mr. Chairman.

I am grateful for the opportunity to be here this afternoon to discuss the administration's merger policy with the committee. One of my priorities since taking this new job has been to clarify, to the extent that could be done, the criteria which the Department will apply to mergers. The law in recent years, I think, has afforded relatively little by way of guidance to the business community as to what is permissible.

The primary statute that is involved here, of course, is section 7 of the Clayton Act, which says that a merger is unlawful where the effect may be substantially to lessen competition in any line of commerce in any section of the country. I refer to section 7 because it is the most recent legislative embodiment of the legislative will. In doing so, I do not mean to suggest that section 1 of the Sherman Act, which also applies to substantially all these cases, carries any different, greater, or lesser standards of illegality than does section 7 itself.

It seems to me the language of section 7 is entirely sound. It puts the focus of judicial scrutiny and administrative scrutiny precisely where I think it should be, on the question whether—looking forward as we must and bringing to bear the best predictive tools we have at our disposal—it seems likely that, at the time the merger is proposed, it may substantially lessen competition in some identifiable line of commerce.

The evolution of this law over the last 20 years—30 years actually since its enactment, but it did not receive much by way of interpretation in the first 10 years of its existence—has been quite confusing, sometimes confused. The first significant interpretation of section 7 by the Supreme Court came in the *Brown Shoe* case. In that case the Supreme Court suggested a very, very large number of factors which were appropriately considered, it thought, in determining the legality of a merger.

Unfortunately, that opinion gave no indication whatsoever how that multitude of factors was to be combined, or how one factor was to be weighted or balanced off against another. When one is handed such a large number of factors without guidance as to balancing, the result is total uncertainty and total subjectivity.

Partly, I think, because of the unworkability of the criteria, the very large number of criteria enumerated in the *Brown Shoe* case, the Federal courts not very long thereafter—I have in mind in particular the *Philadelphia National Bank* case, which I think came in 1963—retreated to what members of the Supreme Court themselves characterized, and I think appropriately, as the Supreme Court's numerology phase.

There was a period of years in which the Supreme Court announced a single, and in my view terribly simplistic, criterion of legality, namely, whether the market shares of the two companies involved added up to 30 percent. As one might have expected would be the case with so simplistic a standard, the judges themselves

were not really prepared to live with it, and as a consequence they engaged in what I think can only be characterized as game-playing with the process of market definition. It is always possible to define the markets that are involved in a variety of ways, and, by defining them more or less encompassingly, it is always possible to produce higher or lower market share numbers.

The period that I have characterized as the period of numerology did, in some sense, reflect the static structuralism of the industrial organization literature and learning of the thirties, forties, and fifties. That literature over the past 20 years has become a great deal richer, a good deal more sophisticated, and, of course, the courts themselves in the last 6 or 7 years have made a very substantial amount of progress in moving to criteria which are better indicators of that probability which must be assessed, namely, will competition be lessened in any identifiable market?

I have in mind in particular the *General Dynamics* case and also the *Marine Bancorporation* case, in which the Supreme Court discussed at some length the importance of employing realistic market definitions, renouncing at least implicitly the sorts of games that had been played in such earlier cases as *Rome Cable.*

The Antitrust Division itself has moved a very considerable way, just as the courts have done so. The Division's enforcement policies have become more realistic. The focus of the Division's enforcement activities in recent years has been primarily on the question of horizontal effects, which is to say the same thing as a lessening of competition.

However, although the action of the Antitrust Division moved in this respect, it did so without any explicit recognition or renunciation of a variety of other theories that had been suggested by various courts from time to time, but which had come to be recognized by the economics profession, by the antitrust bar and by the Justice Department itself as being substantially without any foundation in fact.

With movements of the several kinds I have described, the result was a very, very high level of uncertainty for the business community and for the bar which attempted to introduce them. Although the Antitrust Division's enforcement policies had been modified substantially over the years, the guidelines which it had published in 1968 had remained unchanged.

At the time the guidelines were published, it was stated as part of those guidelines that they were intended to be revised as learning occurred through experience, but, in fact, they were never revised. As a consequence, the guidelines were and are at substantial variance from the actual practices of the Division and from more recent judicial opinions.

We have been at work at the process of writing new guidelines since May or June of this year. We hope that it will be possible to promulgate a new set of guidelines, perhaps in the late winter or in the early spring. Our goal in those guidelines is to provide a concise description of the analysis which the Division itself intends to impose on the merger cases that come before us.

We hope very much that that description can be couched, to the extent it is at all possible, in relatively objective terms so that a person reading the guidelines will have some indication of where

the Division will be likely to come out in a particular case. In short, we are most anxious that we not repeat the error of the *Brown Shoe* Court and simply say, "Here are six or eight criteria. They are all relevant but, unfortunately, we cannot tell you how much they count or how you bring them together in order to determine a result."

This is not an easy undertaking, and I am reluctant at this point in time to describe any particular formulations of how those principles—considerations would be a more accurate term—might interrelate to enable one to take such an objective approach. I am reluctant because we have not finished our work on that task, and any premature effort on my part to do that seems to me to run not only a grave risk but a very high probability of generating more uncertainty than already exists in this area.

On the other hand, I do not see that there is any substantial down side in mentioning some of the factors which we would like to bring to bear, in a relatively quantified way if we can find one, because we think that they are shown by well-validated, empiric studies of industrial behavior to be germane to the question: Is this merger likely to substantially lessen competition in an identifiable line of commerce?

The initial task, of course, is one of describing the process of defining the relevant market. How broadly is it to be defined, either in geographic or product terms? Markets can always be defined more or less broadly, and the considerations which lead one to use, one definition rather than the other require serious attention.

The second problem is that of attaching some quantifiable number that describes the level of concentration that presently exists in any given industry. In the legal community, by far the most popular and in some sense to the exclusion of all other criteria has been the four-firm concentration ratio, and certainly economists have used it too.

However, it is a very, very narrow measure of concentration. It implicitly suggests that it makes no difference how market shares are distributed among the first four firms. It also implicitly suggests that it makes no difference how market shares are distributed among the fifth through ninth firms in an industry. Certainly both of those propositions are wrong.

I do not mean to suggest that we wish to abandon it, rather, I suggest simply that we do not think it captures enough of the features of any particular industry to be the exclusive referent. It is our view that one must take account of the size distribution of market shares from the first firm to the seventh or eighth or ninth or some such number, and that it does make a difference how those market shares are distributed both above and below number four.

Other factors which we hope to bring to bear on these considerations, because they are germane to the probability that a merger will have anticompetitive effects, include such factors as the rate of technological change which the industry has experienced in recent years; the amount of capital that must be put at risk in order to enter the industry, and that is a different concept than the cost of entry, and the stability of market shares among the leading firms in the industry.

Is the same firm first year after year or do the positions in the industry exhibit high levels of instability? How durable is the product? It makes a great deal of difference whether you are talking about electricity, for example, which cannot be inventoried at all, or beer, which can only be inventoried for a period of a few weeks, or whether you are talking about trucks, which will be around and in use 10, 15, and sometimes 20 years after their manufacture.

The characteristics on the buying side of the market also can be very important. The rate of growth of aggregate demand that confronts the industry is a very important factor.

Some or all of these things should be brought into play. However, on the other hand, it seems to me almost preferable that all be left out entirely than that some group of them be brought into play without any concept of how they are to be rated, how much they count. That is really the difficult part of the job to which we have set ourselves.

Until we have finished that task as best we prove able to do it, we intend to administer section 7 primarily by applying the general principles that are to be found in the cases of the last 6, 7, 8 years. They do not afford a great deal of guidance, to be sure, but we will not have subtracted from such guidance as was there. Our commitment is to add more certainty as soon as we can.

I am quite clear in my own mind that this is the right course. It is perfectly true there have been more mergers this year than there were last. It is perfectly true that we seem to be at a relatively high point in merger activity, although most certainly nothing approaching an historic high. One must keep in mind, when looking at those numbers, that in an inflationary economy the dollar value of mergers, like everything else, goes up by the inflation rate. If one measures merger activity in constant dollars, one gets a different and much more realistic picture.

In any event, it would seem to me clearly inappropriate to alter enforcement standards because there is thought to be a high level of merger activity occurring. However high the level of merger activity, there will be many mergers among the set that are highly pro-competitive, will yield significantly lower costs and lower prices to consumers, and most certainly should not be stopped. Indeed, finally, if anyone thought they should be stopped they would nevertheless have to confront the unmistakable language of section 7, which says that a merger is only unlawful where it appears that the merger is likely substantially to lessen competition in an identifiable line of commerce.

That concludes my prepared statement, Mr. Chairman, and I would be happy to answer any committee questions that there may be.

Senator SPECTER. Mr. Baxter, turning first to the issue of the effect of the budget cuts on your Department, I note that the Antitrust Division is due to be cut by almost $6 million, some $5,948,000, which is a reduction from $49,569,000 to $43,618,000, so that your Department has absorbed a 12-percent reduction as contrasted with the 6-percent reduction that other divisions within the Justice Department sustained.

My first question is, why the disproportionate 12-percent reduction contrasted with 6 percent for other divisions?

Mr. BAXTER. Well, I am by no means an expert on the budget of the entire Department, Mr. Chairman, but let me answer that as best I can. Last spring, I believe that the other litigating divisions at the Department, and indeed the other parts of the Department in general, were cut by about 6 percent. The Antitrust Division at that time was not cut at all because it was thought that there was some possibility that it might be asked to absorb the enforcement functions of the Trade Commission.

When the most recent round of cuts came around, everybody else was cut an additional 6 percent, bringing them to 12, and we were cut the entire 12. If you want to know, it is perfectly true that I am feeling bruised in that respect, not so much because I do not think the Division can survive over time with a 12-percent or indeed a somewhat greater percentage reduction in its budget, but just that it came upon us so suddenly that the process of adjustment will be more painful than if we had had spaced 6-percent cuts.

However, we will accommodate to that budget reduction as best we can. When one must cut quickly without a great deal of lead time, one must of necessity cut what is variable and leave untouched what is fixed, and that is not always an optimum pattern. However, we will work out of that as the time we have to make adjustments——

Senator SPECTER. What do those bruises, as you put it, do to your ability to enforce the antitrust laws?

Mr. BAXTER. I do not think they will seriously impact our activities. The Division has grown very, very rapidly in recent years. Its budget has doubled from about $25 million to about $50 million over some relatively short period of years.

Senator SPECTER. What is the inflation factor there?

Mr. BAXTER. Well, obviously, inflation must be taken into account. The increase would be less if one did it in constant dollars, but nevertheless very substantial.

Senator SPECTER. We heard from Attorney General Smith on Friday concerning the Task Force on Violent Crime, and a number of members of the committee expressed grave concern about the reduction of resources in terms of the attack on violent crime. I think there would be similar concern here as to your ability to do the job; especially, as you say, absorbing that kind of a cut all at once.

There has been concern expressed already today, and I am sure there will be more, about the apparent executive decision not to enforce some of the judicial decisions which exist at the present time in the antitrust field. I have before me testimony which you gave before the House. In response to a question from Mr. Seiberling as to areas which you would not enforce you answered: These decisions have not been overruled, no.

There was a lot of concern in Justice O'Connor's confirmation hearings about judicial activism and the courts, in effect, making decisions concerning what is essentially legislative policy. I think that there is even more concern for the Antitrust Division to be making decisions as to what the Congress has enacted and the courts have interpreted, assuming that the courts have not been judicial activists but the Congress has let their decisions stand.

Why do you think it is appropriate for the Antitrust Division to be cutting back on specific areas reflecting specific decisions where

the law has been interpreted to say that conduct is an antitrust violation?

Mr. BAXTER. The statute with which we are working contains a fairly general but nevertheless quite clear standard. It asks whether the probable effect of a merger is that competition will be lessened in an identifiable line of commerce. Of necessity it refers to some body of knowledge or theory from which one must make predictions, and the only possible body of knowledge to which it could refer is what it is that we know at any given point in time about industrial organization.

The courts have from time to time speculated that a variety of factors might bring about a lessening of competition in particular markets. It is clear in retrospect that there was no factual basis for some of those speculations. It is clear——

Senator SPECTER. With all due respect, who are you to say that when the court has said the contrary?

Mr. BAXTER. Well, the court's holdings certainly are interpretations, but the court's findings, that particular conduct in a particular context would be anticompetitive in the circumstance in which they made those determinations, do not seem to me to compel future factual inferences about the effects of particular organizational characteristics.

Senator SPECTER. However, that is the nub of it as it seems to you. The issue is whether it is an appropriate exercise of discretion for the Assistant Attorney General in charge of the Antitrust Division to say what seems to me to be determinative contrasted with what the courts have held to be antitrust violations.

Mr. BAXTER. The courts have never departed from the fact that section 7 requires a determination in the context of an individual merger that the characteristics in that industry must be such as to create a likelihood that there will be a substantial lessening of competition, and that is precisely the view that we are taking of these mergers.

Senator SPECTER. Mr. Baxter, you have been quoted as saying that you would not be at all disturbed if the Robinson-Patman Act were repealed. Do you intend to enforce it as long as it is on the books?

Mr. BAXTER. As long as it is on the books, any time we come across a Robinson-Patman case which offers the same sort of gains in consumer welfare as the cases arising under the Sherman Act and Clayton Act, which we also enforce insofar as the funds available allow us to enforce them, yes, we would bring those Robinson-Patman cases too.

Senator SPECTER. I infer that—given your limited resources and the other enumerations—that it is a very low priority item to get to if in fact you get to it at all.

Mr. BAXTER. There are a variety of cases that arise under the Robinson-Patman Act that would seem to me to offer very little by way of gain to consumers if they were brought. One can imagine other cases that should compete effectively for enforcement resources.

Senator SPECTER. You have been quoted as saying that you intend to intervene on the side of defendants to roll back rulings which have outlawed efforts by suppliers to maintain minimum

prices, to tie the purchase of one product to another, or to deal with only one company in a given area. Those involve three substantive categories which have been very important traditionally in antitrust law violations: No. 1, the maintenance of minimum prices; No. 2, tie-in sales; and No. 3, dealing with only one company in a given area.

What is your justification for abandoning those traditional categorizations of antitrust violations and, in effect, again shifting the law?

Mr. BAXTER. I don't see them as abandonments. Again, with respect to two of the three things you mentioned, the prohibitions you are referring to appear in section 3 of the Clayton Act. The tie-in sales are brought under the prohibition against conditioning, no seller shall condition, and so forth, and so also are requirements contracts, or exclusive dealing arrangements.

Again, you will recall that section 3 of the Clayton Act says that one shall not do these things where the effect may be substantially to lessen competition in any identifiable line of commerce. The wording is very much the same as the wording in section 7.

It is perfectly true that in certain industrial circumstances any one of those practices may give rise to a probable danger to the intensity of competition. Where that is so, we will of course bring the cases. Again, it is, in my view, more a matter of being faithful to the wording which Congress wrote into that statute than it is a matter of abandonment.

Again, there has been widespread speculation that certain kinds of behavior always have anticompetitive effects. It is now quite clear that that is not true. It is now quite clear that activities of all those kinds can reduce costs of distribution and lower prices to consumers in other industrial settings. In short, the legality of those practices depends very much on the behavioral setting in which they find themselves, and we expect to bring cases against them wherever their effect may be substantially to lessen competition.

Senator SPECTER. One more question, and then I will defer to my colleagues. You have been quoted as saying—as this particular issue refers to the *A.T. & T.* suit but it would be applicable to the whole range of antitrust policy—and this appears in the Wall Street Journal of October 9, this year, that as to the dropping of the *A.T. & T.* suit:

> The decision rests with the Cabinet and ultimately in the hands of President Reagan. Mr. Baxter said the Cabinet Council had not considered whether it would agree with him that the amendment's shortcomings

referring to the Telecommunications Act

> would warrant continuing the suit if the bill became law.

Is that essentially a correct quotation?

Mr. BAXTER. The first sentence or two, which I am not sure I heard, does not sound like a correct quotation, but I would be happy to hear it again, Senator, if you would, please.

Senator SPECTER. I will start one sentence earlier:

> Even if the Council and Congress fail to agree on a version acceptable to Mr. Baxter, that would not necessarily kill the chances that the *A.T. & T.* suit would be dropped. The decision rests with the Cabinet and ultimately in the hands of President Reagan. Mr. Baxter said the Cabinet Council had not considered whether it

would agree with him that the amendment's shortcomings would warrant continuing the suit if the bill became law.

Mr. BAXTER. That sounds to me like a very confused quotation. I would be happy to tell you——

Senator SPECTER. Well, my specific question is, do you think that the Cabinet has any decisionmaking function on the dropping of the *A.T. & T.* suit?

Mr. BAXTER. No, I do not, and I——

Senator SPECTER. Therefore, to that extent the quotation is incorrect?

Mr. BAXTER. Yes, if that is what the quotation is really saying; the language there sounds fairly garbled to me. As I said before this committee once previously, I do believe the administration is entitled to have its own telecommunications policy, and the *A.T. & T.* case against such a major portion of that industry has the potential for setting telecommunications policy in many respects merely by its outcome.

To that extent, perhaps I could make that more specific by saying, so far as relief in that case goes, it does seem to me not inappropriate for the administration to concern itself with the case. However——

Senator SPECTER. How do you——

Mr. BAXTER. Excuse me. However, they have not done so. While there has been extensive Cabinet Council consideration of telecommunications policy, of proposed amendments to S. 898 and so forth, the Cabinet Council has not made any recommendations to me on the dropping of the suit.

Senator SPECTER. Well, how do you square that with the provisions of the United States Code with respect to the Department of Justice which say specifically that the control of litigation is to be left with the officers of the Department of Justice and the Attorney General?

Mr. BAXTER. I thought that was what I just said.

Senator SPECTER. Well, would you mind repeating it?

Mr. BAXTER. Yes. They have not concerned themselves with the dropping or pursuit of that litigation. While I have participated very actively with the Cabinet Council in working on the legislation in the Senate, the Cabinet Council has not addressed the pursuit of the lawsuit.

Senator SPECTER. Therefore, you are saying that those decisions are solely yours and those of the Attorney General?

Mr. BAXTER. Yes. Well, the Attorney General has recused himself with respect to that particular lawsuit.

Senator SPECTER. It would not even be a matter properly for the President; correct?

Mr. BAXTER. I would think it would not properly be a matter for the President.

Senator SPECTER. Well, I would agree with you on that.

Senator Kennedy?

Senator KENNEDY. Thank you, Mr. Chairman.

I would be interested in finding out your own views about the importance of small businesses in this country, and their ability to compete and survive. How important is that, to you?

Mr. BAXTER. It is difficult to think of anything more important.

Senator KENNEDY. Excuse me?

Mr. BAXTER. I say I find it difficult to think of anything more important. What one observes when one looks at almost any industry in the United States is a sort of industrial life cycle: New companies bring the new technology into existence. I think there is not much doubt that in the preponderance of cases, new companies are far more than proportionate contributors to the development of new ideas and new technologies, as those——

Senator KENNEDY. Do you think that the small business community feels that they have a friend in the antitrust division with you as the Assistant Attorney General for Antitrust?

Mr. BAXTER. I haven't any idea what they feel.

Senator KENNEDY. You do not have any idea what they feel?

Mr. BAXTER. No, I do not.

Senator KENNEDY. Do you care?

Mr. BAXTER. Well, I certainly would be interested.

Senator KENNEDY. Well, let me enlighten you a little bit, at least as far as the reports in the Wall Street Journal, an article on July 8 of this year:

> While big business cheers, smaller enterprises view the trend with alarm. Bill Baxter scares the pants off us, says Jerome Gulan, the vice president of the National Small Business Association. Historically one goal of antitrust has been to prevent big companies from gaining too much size and power. Mr. Baxter has little patience with such goals. Asked if increasing the concentration of wealth and power in fewer conglomerates would trouble him, he replied, In a word, no.

Do you think Mr. Gulan's attitude is typical of the small business community in terms of their assessment about the policy decisions that are being made in the Department now?

Mr. BAXTER. I do not know whether it is typical. I know that as——

Senator KENNEDY. Are you surprised that Mr. Gulan feels that way?

Mr. BAXTER. No, not particularly.

Senator KENNEDY. Why not?

Mr. BAXTER. Oh, I know there is bound to be an enormous range of opinion on almost anything.

Senator KENNEDY. Well, that is not what—do you want to read back my question?—that is not what I asked you. I asked you whether you were surprised that one of the principal spokesmen for a smaller business association feels that you are not protecting the interests of small business.

Your answer, I think, was that you are not surprised because there are so many different views on everything. Do you think that that is atypical or typical of those that speak for small business in this country?

Mr. BAXTER. Well, it would depend on what segment of small business. I would expect small business——

Senator KENNEDY. Would you tell us, then, what part of small business do you think supports the kinds of decisions that you are making, and what aspects of small business differ with it now?

Mr. BAXTER. I would think that small businesses that were involved in technologically intense activities and were concerned about the level of protection that inventions and intellectual property would receive would be quite pleased. I would think that

highly successful small businesses which had reached the point where they wanted to be acquired by a more production-oriented company and achieve some degree of capital liquidity in the estates of the developers and innovators who brought them into existence would be extremely pleased.

I would think that small business units which had——

Senator KENNEDY. Have they ever indicated that to you? Have any of those companies or corporations or organizations indicated that to you?

Mr. BAXTER. No. I have not been talking to——

Senator KENNEDY. Do you think it is important to talk to those groups?

Mr. BAXTER. I think it is important to talk to all groups of the business community.

Senator KENNEDY. Well, I am asking you, when was the last time that you sat down with representatives of the small business community and talked over your antitrust policy?

Mr. BAXTER. I have had a number of relatively small businesses in to talk to me about what they would like to see in the telecommunications bill and their attitude toward the *A.T. & T.* case. They seemed quite pleased with my attitude.

Senator KENNEDY. Well, there may be some understanding of that but can you tell us, have you sat down with any of the small business organizations, representatives of any of the small business associations, about merger policies?

Mr. BAXTER. I have had one extended discussion, interview with an organization, the name of which I am not certain I can recall, but it was sort of a trade association of the trade association representatives of a large number——

Senator KENNEDY. Do you think it was representative of the small business organizations or groups?

Mr. BAXTER. They represented themselves to be.

Senator KENNEDY. You believe that to be so?

Mr. BAXTER. Yes.

Senator KENNEDY. What is the name of the group?

Mr. BAXTER. I do not know although——

Senator KENNEDY. You do not know?

Mr. BAXTER [continuing]. One of my colleagues may recall it.

No, he is not certain right now either.

Senator KENNEDY. The Business Round Table or the——

Mr. BAXTER. No, no, it was not the Business Round Table. [Laughter.] No, it was a group of——

Senator KENNEDY. Do I understand that since you have assumed these responsibilities, that you have not sat down with any of the small business associations or small business organizations and talked to them about merger policy?

Mr. BAXTER. No, that is not correct.

Senator KENNEDY. Then will you tell us which groups that you met with and when you met with them?

Mr. BAXTER. I would be glad to submit that for the record.

Senator KENNEDY. You do not recall? I mean, just so that the record is clear now in terms of your testimony before this committee, you have no clear recollection of any of those meetings?

Mr. BAXTER. No, that is not correct. I have a very clear recollection——

Senator KENNEDY. Well, then, will you recollect for us?

Mr. BAXTER. Yes. I recollect meeting for about 2 hours one afternoon in a building on K Street in the vicinity of 18th, on the second floor, I believe, with about 20 or 25 gentlemen, each of whom was the head of some particular small business group, and we talked about a variety of antitrust policies.

Senator KENNEDY. Whose office was this?

Mr. BAXTER. I do not recall. I am sure I can find it on my calendar.

Senator KENNEDY. That is it, as far as your recollection?

Mr. BAXTER. That is the only meeting I can presently recall with a trade association.

Senator KENNEDY. Do you think it is useful for someone who has given the kind of statement that you have given here in terms of your commitment to the small business community and their importance in terms of innovation, creativity, new jobs, that it would be of some value to sit down with them to talk about merger policy?

Mr. BAXTER. Oh, it might be.

Senator KENNEDY. It just might be?

Mr. BAXTER. It just might be.

Senator KENNEDY. However, you do not have any plan to at this time?

Mr. BAXTER. No.

Senator KENNEDY. Well, then, I think it is fair for us to put your earlier statement in some kind of context, don't you? That would not be unreasonable for us to do, having heard the comment and statement, your words about commitment to small business on the one hand, and then your indication that you only think it may be of some value for you to sit down with those groups and those organizations that would be most directly affected, that part of the economy that would be most dramatically affected by your decisions—and your answer is that it might be.

Mr. BAXTER. No, I disagree with the premise entirely. I think the merger policy is relatively a matter of indifference to the small business community.

Senator KENNEDY. How do you know if you have not talked to them?

Mr. BAXTER. Oh, I have talked with a very, very large number of businessmen, large and small, over the years.

Senator KENNEDY. I think we have been over that ground. We will let the record stand. However, I would welcome it if you would provide for the record the various small business organizations or groups that you have talked with about merger policy since you have assumed this position, if you would submit that.

Mr. BAXTER. Yes, Senator.

[The following material was subsequently supplied for the record:]

Assistant Attorney General Baxter met with the Antitrust Committee of the Small Business Legislative Council of the National Small Business Association on June 16, 1981 to discuss antitrust policy, including merger policy. The Council is comprised of 84 national and regional associations representing small businesses.

Representatives of small businesses have also discussed their views concerning specific mergers with Division officials conducting investigations of those transactions.

Senator KENNEDY. Now also in the Wall Street Journal they point out: "Some antitrust experts attribute this activity" they are talking about the wave of merger activity "to uncertainty about antitrust policy. According to these experts, corporate executives think the Reagan administration may accept mergers that would have been stopped by former President Carter's aides. Recently Attorney General William French Smith fueled such talks by saying, 'There is nothing inherently wrong with bigness in the business world.' "

Do you think there is any uncertainty about antitrust policy?

Mr. BAXTER. I think there is and has been for a number of years a good deal of uncertainty about what mergers are permissible and what are not.

Senator KENNEDY. However, is there uncertainty about the administration's policy?

Mr. BAXTER. I think there undoubtedly is and will continue to be until we manage to come out with some merger guidelines. I am quite clear that an increase in merger activity cannot be prompted by an increase in uncertainty. Uncertainty can only deter any activity.

Senator KENNEDY. Well, I do not think there is any question that the definition of "market" is necessary before you can weigh the extent to which the market of competing sellers or buyers has been cut off, but if you make a detailed evaluation of every trend and potential development in the industry, don't you effectively guarantee endless litigation and insure that the Government will rarely if ever be successful?

Mr. BAXTER. No.

Senator KENNEDY. Isn't that why the Supreme Court's approach to the foreclosure of markets is basically the only way that makes sense if the law is to have any effectiveness?

Mr. BAXTER. Well, if you are referring to the approach of the Supreme Court in the 5 or 6 years following *Philadelphia National Bank,* it seems to me to illustrate quite clearly that that is not the case. It was operating under what purported to be highly objective criteria but, in fact, it introduced incredible uncertainty into the law by engaging in the most whimsical process of defining markets, and the litigation went on endlessly over that point.

Senator KENNEDY. When are your vertical guidelines going to be ready for congressional review?

Mr. BAXTER. In late winter or early spring.

Senator KENNEDY. You will consult with the committee before they are promulgated?

Mr. BAXTER. That had not occurred to me. Would the committee find that useful?

Senator KENNEDY. Yes, I would think so. What is your response?

Mr. BAXTER. I do not see any reason why we cannot do that.

Senator KENNEDY. Can you supply for the committee a record of changes made in the Division's enforcement efforts under your leadership? I would like you to include a list of all the cases which you dismissed or settled after taking a different position than your predecessors on the nature of the possible violation and the relief

necessary to remedy it. I would also like the same information for cases that are still active, if possible, in which the Division has changed its position before the Court.

Mr. BAXTER. The list of cases that we have dismissed would certainly be possible, and that would generally reflect a change in position. A list of cases that we have settled as a result of a change in attitude would be an extremely subjective list. I would be delighted to give you a full list of cases settled or dismissed.

Senator KENNEDY. What I am basically getting at, which you understand, is to try to get a better understanding and awareness, by the actions of the Department other than just words, by the cases in which there were recommendations by the previous administration. You have made a review of those cases and taken a different position with regard to either dismissing those cases or settling, and I think it would be useful for us in examining the antitrust policy and obtaining a better understanding of what is happening to have that kind of information.

Mr. BAXTER. Yes. I would be happy to get a list of cases where I am aware that any change in policy was germane to the disposition of the case.

[The following material was subsequently supplied for the record:]

Whenever the Antitrust Division decides to settle an antitrust case on the basis of a consent decree, it reflects the judgment of Division officials as to the most appropriate means of protecting the public interest in the circumstances of the particular case. Thus, in most cases it will be a matter of speculation whether the case would have been settled on precisely the same terms by different officials. In the following cases, however, modified antitrust policy positions played a significant role in the Antitrust Division's conclusions concerning the appropriate disposition of the case:

CASE AND DISPOSITION

United States v. *Mack Truck, Inc.*, (filed Jan. 12, 1981).—Dismissed July 8, 1981.

United States v. *Ibstock-Johnson Limited* (filed July 21, 1980).—Dismissed July 8, 1981.

United States v. *General Electric Company* (filed May 18, 1972).—Dismissed Oct. 14, 1981.

Senator KENNEDY. Do you think that the perception that is generally around in Wall Street is a fair one—I am just referring to the series of different articles here, and I can refer to them, I will include them all in the record, where this point is made—that almost any vertical merger and most horizontal mergers can now be tried and run little risk of challenge by the Government?

Mr. BAXTER. No.

Senator KENNEDY. Why do you believe that this perception exists?

Mr. BAXTER. I do not believe that perception exists. If it does, people certainly have not——

Senator KENNEDY. Well, we certainly have read some of the examples into the record. The Wall Street Journal is not generally considered to be a democratic organ, and the series of articles have drawn that conclusion. You have challenged that and I would like to hear you out on it. Why has there been a series of different articles during the period of the last 3 or 4 months with that statement or that comment or that conclusion?

You have been around this town long enough to know that these perceptions do not just appear. It may appear one time, it may appear a second time, but if it appears repeatedly there must be at least some reason for it, maybe a wrong reason for it. I am giving you a chance to clear that up. I would like to hear your response.

Mr. BAXTER. Well, I read the Wall Street Journal quite regularly and I have not seen any such perceptions. It seems to me its reporting is fairly accurate. I would be happy to repeat what I read in it as having heard me say, and that is that there are situations in which vertical mergers or conglomerate mergers can have significant and adverse effects on competition in identifiable markets because they affect the relationship between horizontal competitors in those markets.

Notwithstanding that, the mergers themselves are vertical or conglomerate. Except for vertical and conglomerate mergers having such potential effects, we do not regard the requirements of section 7 as being met.

On the other hand, as for horizontal mergers and particularly in view of the fact that our policies will call for fewer attacks and therefore a freer capital market with respect to conglomerate and vertical mergers, a substantially less significant departure from prior standards seems to us appropriate. We will continue to attack mergers which threaten substantially to increase concentration in markets which have already reached rather high levels of concentration. The proposed Heilman-Schlitz merger that we recently announced an intention to challenge is an example.

Senator KENNEDY. Well, my time has basically run out but I think that I would take issue with you, although you have the responsibility for this, if you do not believe that there is a clear perception on Wall Street or in these series of articles, and I quote:

> Some antitrust experts attribute this activity to uncertainty about antitrust policy. According to these experts, corporate executives think the Reagan administration may accept mergers that would have been stopped by former President Carter's aides.

In another article—and I will put them all in the record—talking then about the oil company mergers in another article:

> Federal Trade Commission prosecutors advised the Commission to drop its 7-year-old antitrust case against the Nation's eight largest companies, a suit that some lawmakers had hoped would lead to the breaking up of the oil giants. That move, plus other indications by the Reagan administration of a more relaxed antitrust stand, has prompted oil companies to become acquisition-minded again.

If you do not believe that that is the perception, I just believe that you have not been reading those newspapers or listening to what they are talking about in terms of Wall Street on that issue.

Mr. BAXTER. I did not notice any reference to horizontal mergers in that statement.

Senator KENNEDY. Excuse me?

Mr. BAXTER. I did not notice any reference to horizontal mergers in that statement.

Senator KENNEDY. It is talking about oil companies in the article, and which I will include in the record, both horizontal and vertical. It is the July 8 issue that goes on to some extent, and it refers in both of those areas—and I will come back and review that with you

when the time permits—but it refers in this article to both horizontal and vertical.

Mr. BAXTER. The name of the small business group with whom I met on the afternoon to which I referred, Senator, is the Small Business Legislative Council of the National Small Business Association. The particular gentleman who asked me to appear was their legislative director, Mr. Jerome R. Gulan, and the meeting was at 1604 K Street on June 16.

Senator KENNEDY. The subject of that meeting was on mergers?

Mr. BAXTER. No, a general discussion of antitrust policy including mergers.

Senator KENNEDY. Now, was that the one at which Mr. Jerome Gulan was present?

Mr. BAXTER. I assume it was.

Senator KENNEDY. After that particular meeting, Mr. Jerome Gulan said, "Mr. Baxter scares the pants off us" on these particular policies.

Thank you.

Senator SPECTER. Senator Metzenbaum?

Senator METZENBAUM. Mr. Chairman, with your permission I would like to ask some questions and then I must leave for a 4 o'clock meeting. I will return, if that is permissible, and I would appreciate it if my interrogation might be put together by the reporter in the appropriate manner.

Senator SPECTER. Certainly. Senator Metzenbaum, your questioning will appear without interruption.

Senator METZENBAUM. I thank you.

Mr. Baxter, Senator Kennedy has inquired of you with respect to merger policy and the change of the policy, and the perception of the economic community. I am concerned about your policies from the standpoint of obeying the law, since you are a law enforcement official, and the confusion that you are creating out in the countryside.

The press reported that at the August ABA meeting the new chairman of the ABA antitrust section, a noted defense lawyer, Mr. E. William Barnett, wondered how he could advise clients, holding your speeches in one hand and the Supreme Court's opinions in the other. According to the Legal Times of August 17, 1981, other panelists at the meeting "all reminded the audience that Baxter's less restrictive view of mergers was not the prevailing law in many circuits or in the Supreme Court."

My question is: How can the Nation's chief antitrust enforcement officer not follow the Supreme Court's views on these matters, views that have never been overruled or even judicially questioned, and were almost always unanimous with respect to vertical mergers, concentration, and the like? How can you find these nuances and these distinctions to keep from obeying the law? Lawyers say, "We really do not know what is going on in the country and do not know how to advise clients."

Mr. BAXTER. Well, I start by reading section 7 of the Clayton Act.

Senator METZENBAUM. What does that do? Does that change when you read it? Does that change the Supreme Court's interpretation of it? Do you have the right to do that?

Mr. BAXTER. It makes quite clear what the legal standard applying to mergers is.

Senator METZENBAUM. Now, Mr. Baxter, you were a law professor, weren't you?

Mr. BAXTER. I used to be.

Senator METZENBAUM. As a law professor, you taught your students that the law was the way the Court had enunciated it, and you did not go back and tell them it was the way Mr. Baxter, the law professor, interpreted it. Now, you are sitting here and suggesting that you can change the law by reading section 7 and disregard entirely the Supreme Court opinions.

Mr. BAXTER. No, I am not suggesting I can change it. I am suggesting there is a standard announced there; that we are following it; that the Supreme Court has followed it waiveringly and inconsistently over time; that the opinions in such cases as *General Dynamics* and *Marine Bancorporation* and other recent cases inevitably undermine the *Philadelphia National Bank* line of cases, just as the *Philadelphia National Bank* line of cases undermined *Brown Shoe.* There is no clarity.

Senator METZENBAUM. I am only referring to the experts in the field. I am not an expert. Experts at the ABA antitrust section, headed up not by some plaintiffs' lawyers but by defense lawyers, are saying, "How do we advise clients when the Supreme Court says one thing and Baxter is saying another thing?" You are saying, "Well, that is because they do not understand it."

However, all of the people, apparently, at that ABA convention were saying the same thing: That they did not know which way to turn because you are changing the law. I just am questioning how you can do that.

Mr. BAXTER. I was present at that ABA meeting. That was a question that was put to me and I said, "One cannot ignore the risk that one's client might get sued for treble damages, and it is a risk you have to take into account." There really was not much doubt about that.

Senator METZENBAUM. Well, you have taken some very definite positions on concentration, and vertical and conglomerate mergers, and other vertical arrangements like resale price maintenance. With respect to increases in concentration, for example, you have often indicated that you are not particularly disturbed by that either.

Mr. BAXTER. No, I do not think I have, Senator.

Senator METZENBAUM. In Dun's Review, August 1981, page 38—and I ask unanimous consent that that excerpt be included in the record at this point——

Senator SPECTER. Without objection, so ordered.

[Aforementioned article follows:]

Big Shift in Antitrust Policy

Carter trustbusters fought large mergers tooth and nail. In sharp contrast, Reagan antitrust chief William Baxter says he won't "wage war against aggregate concentration."

Last month, E.I. du Pont de Nemours & Co. made a $7.4 billion bid for Conoco, Inc. which, if it goes through, will be the largest acquisition ever. Other recent multibillion dollar acquisitions include Fluor Corp.'s purchase of St. Joe Minerals Corp. for $2.7 billion and the $2 billion bid by Standard Oil Co. (Ohio) for Kennecott Corp. In the second quarter of 1981, the number of mergers rose 36% after a 46% jump in the first quarter. The six months saw a record of $35.7 billion in mergers.

A major factor in this new merger wave is surely Wall Street's belief that the Administration will take a less aggressive approach to the antitrust laws than did the Carter White House. And William Baxter, Assistant Attorney General for antitrust, is proving the validity of this view. The former Stanford Law School professor rejects the populist notion, favored by the Carterites, that big is bad. Rather than viewing antitrust as a tool to protect small business against its bigger rivals, he sees its function as promoting consumers' welfare through greater efficiency and lower prices.

Senior Editor Ann Reilly recently talked with Baxter about his plans to redirect antitrust policy. Here are his provocative views:

Carter Administration antitrust policy was characterized by a fear that before long a handful of giant companies would dominate the nation both economically and politically. Do you perceive this trend toward aggregate concentration in the U.S. economy?

I think the data on whether there is or is not a trend towards aggregate concentration is very shaky. By selecting your own favorite measuring stick and time interval, you can prove anything. For my part, I see no marked trend.

But even if I did, it would not be particularly disturbing to me. There is nothing written in the sky that says that the world would not be a perfectly satisfactory place if there were only 100 companies, provided each one had 1% of every product and service market. In that case, there would be extremely high aggregate concentration and, at the same time, perfect competition. So you see, the two have nothing necessarily to do with one another. Consequently, I certainly do not see a war against aggregate concentration as part of this department's mission.

So-called "shared monopolies" were another favorite target of the Carter trustbusters. John Shenefield, who headed the Justice Department's antitrust division for the first three years of the Carter Presidency, concedes that he was unable to find one good case, even after screening 343 industries. Still, he insists they exist. What do you think?

The problem is that the term "shared monopoly" does not have a generally accepted definition. But for the sake of argument, let's take several definitions with which the division has flirted from time to time. One course would be to use Section II of the Sherman Act, which among other things prohibits attempts to monopolize, to attack ologopolistic industries on the theory that they are somehow behaving monopolistically—even if we are not aware of any collusive arrangements. I don't believe the law can be stretched that far.

But there's another way in which "shared monopoly" is understood. Sometimes firms will enter into agreements—not price fixing, output restrictions or any of the traditional cartel arrangements, but perhaps agreements to exchange information about future price changes or to engage in joint ven-

tures. Such agreements would not be troublesome in most industrial contexts, but in concentrated industries they can facilitate collusive arrangements. Then it's entirely appropriate to attack those agreements with Section I of the Sherman Act, which prohibits arrangements in restraint of trade.

What about mergers between companies in the same industry? When would you consider them a threat to competition?

When there already is a four-firm concentration ratio at or above the 50%-to-60% level, then the disappearance of a significant firm through merger poses antitrust problems.

In light of those criteria, do you think the recent spate of major acquisitions of resource firms by big oil companies presents antitrust problems?

My approach to any merger is exactly the one I've just described. I see nothing terribly special about the energy industry. Some sectors have rather high capital costs for entry, and that increases one's concern about concentration. But after all, we have about twenty major oil companies and a large number of coal producers, hydroelectric plants and natural-gas companies.

If a large integrated petroleum company were acquiring a coal company, I'd have two basic lines of inquiry. First, I'd ask: Is that petroleum company one of a small number of uniquely positioned potential entrants into the coal industry? And I'd assume the answer would be no, since there are about twenty other potential entrants.

Then, I'd look at the merger horizontally. I'd ask: What is the market in which these two companies compete? The answer isn't petroleum because the coal company doesn't compete in the petroleum market, and the answer isn't coal because the oil company doesn't compete in the coal market. The only market one can identify in which the two companies compete is a very broad area called the energy market. But then I'd ask: Is the energy market concentrated? And I'd find that it has a very, very large number of players, and that reduction by one would not affect competition significantly.

What about mergers among competitors in industries, such as automobiles, in which there are only a handful of domestic companies, but many foreign producers fighting for the consumer's attention?

If the market is truly worldwide, then you have to count globally to find out whether the industry is concentrated. I'm not sure that argument has ever been made in a litigated case, but the concept is well established. Indeed, it is essentially the same line of reasoning now used to determine whether a market is regional or national.

In your view then, would a hypothetical merger between Chrysler Corp. and Ford Motor Co. violate the antitrust laws?

You'd have to look at the market shares of all the competitors in the industry—General Motors, Toyota, Datsun, Fiat, Mercedes-Benz, etc. Once you got through counting, you might decide that the automobile industry is really not very concentrated, and so the merger is not troublesome. I haven't done that counting for the automobile industry, so I'm not ready to assert that it would not be a problem. But that's the process.

Sanford Litvack, who succeeded Shenefield as head of the antitrust division, began pushing cases against vertical market arrangements, particularly minimum sale prices. Do you consider such arrangements anticompetitive?

There is a thriving portion of antitrust law that purports to find evil in purely vertical arrangements. I find that approach fundamentally misguided.

Vertical structuring of the economy through long-term supply contracts, exclusive dealing arrangements, territorial restrictions, the selling of products in bundles and even vertical price fixing often promotes efficiency. Such arrangements can only be proclaimed bad in a particular industrial setting, where they have the capacity to facilitate horizontal collusion.

How then would you justify the Robinson-Patman Act, which restricts discounts that manufacturers and wholesalers may give to retailers?

It's a dreadful piece of legislation, very anticompetitive in its effects. The pricing behavior that it forbids in a wide variety of circumstances is impossible to distinguish from healthy price competition. Particularly in concentrated industries, price competition often takes the form of sub-rosa price concessions to

certain buyers. Typically, the secrecy is ineffective. Other buyers find out and demand similar concessions. Then you get a flurry of price competition, lowering price levels throughout the industry.

The Robinson-Patman Act implicitly assumes that price competition should occur through open and simultaneous price cuts available to all. But that's a sixth grade civics class view of price competition. In fact, the act is a highly repressive force on price competition in a variety of industries, among them steel, beer, automobile tires and white goods.

Do you plan to push for its repeal?

It's not high on my priority list. The courts have come to understand the law's anticompetitive effects, and by and large are only grudgingly enforcing it. The Justice Department, for its part, has found few, if any, cases in recent years that justify the use of its resources to prosecute. So while the law is still doing harm, it's probably not doing very much harm.

How about vertical mergers? Under the 1968 Justice Department guidelines, any merger between a vendor with 10% of its market and a customer who buys at least 6% of that vendor's product is considered suspect. Do you worry about such combinations?

I have no concerns about vertical mergers as such. I look at a vertical merger the same way I would look at any other merger. There may be a potential entry problem. There may be some more broadly defined market in which these companies compete; and one would have to ask how concentrated that market would be after the merger. But the fact that two firms stand in a relationship of potential supplier and potential customer is not in and of itself troublesome.

Can you give an example?

A merger between Bethlehem Steel and Ford, for instance, would be a vertical merger. But since Ford has its own steel production facilities, it would also be a horizontal merger. The horizontal aspects of it might be troublesome, but not the vertical aspects. If Ford were one of a very small number of potential entrants into the steel industry and the steel industry were highly concentrated—which it is not—then the merger might also be suspect as a potential competition case, but not as a vertical merger.

What do you see as the primary thrust of antitrust policy under the Reagan Administration?

The role of antitrust policy must be to insure that the competitive process is permitted to function; in particular, that it is not interfered with by private collusive arrangements or disruptive behavior by firms with extremely strong market positions. An equally important goal is to minimize government interference in the marketplace through regulation that is more intrusive than it need be.

How do you plan to achieve those goals?

We're prepared to devote a substantial portion of our resources to discovering those businessmen who are deliberately constructing elaborate schemes to fix prices or divide markets. And when we find them, we expect to indict individuals—sometimes companies as well, individuals whenever possible—and press for actual incarceration as opposed to suspended sentences.

On the regulatory front, I expect continued heavy intervention by the division in administrative proceedings before various agencies. For the most part, I believe that many entry barriers would not exist without government intervention in the marketplace.

What about the ongoing IBM and AT&T cases? Do you expect a quick solution?

There is absolutely no likelihood. Obviously, I'd like to settle them both. But it's not yet proven possible.

In reference to the IBM case, I'm still studying the record. There is nothing that I would call settlement discussions underway. At this point, we're talking about a process for getting me educated, and I have no idea what will happen once that process is completed. The problem with the IBM case is that I'm a slow reader.

You've said you plan to litigate the AT&T case "to the eyeballs." Do you think the Congress should wait for a settlement of the case before enacting pending telecommunications deregulation legislation?

I see no reason on earth why the settlement of any particular case should hold up the passage of desirable legislation.

Are the bills now before the Congress desirable?

That's currently under discussion. So I have no comment. DR

Mr. BAXTER. I believe that refers to aggregate concentration rather than market concentration.

Senator METZENBAUM. As I understand it, you did not say aggregate concentration. I did not say aggregate concentration.

Mr. BAXTER. I did not suggest that you did. I thought that the reference in the piece at that point was to the concept of aggregate concentration rather than to market concentration.

Senator METZENBAUM. Well, we will put the piece in the record——

Mr. BAXTER. And everyone will be able to tell.

Senator METZENBAUM. Congress was very disturbed about concentration when it passed the Clayton Act in 1914 and the Celler-Kefauver amendment in 1950. Let me quote you just one short excerpt from the *Brown Shoe* case discussing the legislative history: "The dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a rising tide of economic concentration in the American economy." There are many other such findings.

Now as recently as, in fact, the *General Dynamics* case that you mentioned as well-decided, the same kind of language was used. My question is, how do you conclude that you as a new appointee should overrule all the Supreme Court decisions in one fell swoop?

Mr. BAXTER. I had not really felt I was doing that. The reference in the *Brown Shoe*——

Senator METZENBAUM. What was your answer?

Mr. BAXTER. I said I had not really thought I was doing that. The reference in the *Brown Shoe* case which you just read is a reference, again, to aggregate concentration. However, if the Supreme Court is right in its attribution of that concern to Congress, then it is remarkable that Congress was so singularly inept in articulating a standard which refers only to competitive effects in a line of commerce in a particular section of the country, and has no reference whatsoever to aggregate concentration.

Senator METZENBAUM. Now, as I understand your position, it is now Baxter on one side and the Supreme Court and the inept Congress on the other. Is that——

Mr. BAXTER. No, I do not believe Congress is inept. I believe it wrote in exactly what it intended to write into section 7.

Senator METZENBAUM. I thought you just said that Congress was so inept.

Mr. BAXTER. I said that if I accepted your attribution of concern, they were singularly inept, but I do not.

Senator METZENBAUM. However, mine is not mine; mine is the Supreme Court's.

Mr. BAXTER. The Supreme Court did say that in the *Brown Shoe* case, but it did not explain how it reconciled it with the content of section 7.

Senator METZENBAUM. Mr. Chairman, I think I have to leave for my 4 o'clock appointment but I see you are going to have to leave also for a bit for a rollcall. Can we possibly recess?

Senator SPECTER. Yes, Senator Metzenbaum, we can recess so that the questioning will be continuous. The buzzer signifies a vote, which means that we have to go. We could go in just a few minutes but it would be equally inconvenient from your point of view to

wait 10 minutes now as to wait 10 minutes later. Therefore, we will adjourn for 10 minutes and Senator Metzenbaum will resume the questioning.

Mr. BAXTER. Fine. Thank you.

[Brief recess.]

Senator SPECTER. The committee will come to order.

Senator METZENBAUM. Mr. Baxter, the Supreme Court has dealt with vertical mergers several times, as you well know and as you have mentioned. In each of these cases, *Du Pont, GM, Brown Shoe, Ford (Autolite)*, the Court ruled unanimously that Congress meant to bar vertical mergers that substantially foreclosed a substantial share of the market for suppliers or buyers. That has never been questioned by the Supreme Court, but you say you do not like those rulings and you are not going to enforce them.

You have been quoted as saying, "Vertical mergers are never anticompetitive." Although the committee report of the Celler-Kefauver Act explicitly says the law is aimed at vertical mergers, you told the ABA this August.

> As far as I am concerned, there is no such thing as a vertical merger. What I mean by that is that a merger is never troublesome just because it is vertical. Mergers are never troublesome except insofar as they give rise to horizontal problems, so that the vertical merger guidelines, so far as I am concerned, simply disappear.

Now, that may be Baxter on mergers but that is not the law, and my question comes back to the point that I raised earlier: Don't you have a duty to enforce the law?

Mr. BAXTER. That is not my view of the law at all, Senator. The Supreme Court has said various things at various times. I have never said that vertical mergers are never unlawful. On the contrary, I have repeatedly said that on occasions vertical mergers do give rise to horizontal consequences in identifiable markets, and when they do they meet the standards of section 7.

Senator METZENBAUM. However, are you going to enforce the Supreme Court decisions with respect to percentages as to which there is foreclosure?

Mr. BAXTER. Percentages as to when? I am going to enforce section 7 against mergers that give rise to a probable lessening of competition in an identifiable market.

Senator METZENBAUM. What would you do if you had another *Brown Shoe* case?

Mr. BAXTER. I would not bring it.

Senator METZENBAUM. You would not bring it?

Mr. BAXTER. It could not be won in the courts today.

Senator METZENBAUM. Therefore, what you are really saying is, it is Baxter on antitrust, and forget about the Supreme Court and forget about the Congress.

Mr. BAXTER. No; I am saying that one has to read the Supreme Court decisions of the last 10 years as well as the fifties and early sixties.

Senator METZENBAUM. The thing I found interesting in your earlier testimony was that you intend to enforce the decisions of the last 6 years and wipe out all the decisions of the earlier years. Did I understand you right?

Mr. BAXTER. One has to pick some particular vintage. The most recent vintage seems to me the most appropriate.

Senator METZENBAUM. What if there were no decisions in a particular area during the last 6 years? Then will you go back to the 7th and the 17th year?

Mr. BAXTER. Well, we have to go back to some particular vintage. One has to decide, for example, what impact the Supreme Court's decision in *GTE-Sylvania* has on the *Brown Shoe* case.

Senator METZENBAUM. That was not a vertical merger, was it?

Mr. BAXTER. It was a case involving vertical practices, and the Supreme Court said a lot of insightful things about vertical practices.

Senator METZENBAUM. That was not a vertical merger, was it? Yes or no.

Mr. BAXTER. It was not a vertical merger case, but that does not mean it is not significant for vertical merger law.

Senator METZENBAUM. No; but the fact is that you try to pull out a case and talk about a case that is not a vertical merger in order to support your position with respect to vertical mergers.

Mr. BAXTER. That is correct, and it is entirely appropriate.

Senator METZENBAUM. Let me ask you a question: Tell me which recent case had to do with vertical mergers, overruling the earlier decisions?

Mr. BAXTER. *GTE-Sylvania.*

Senator METZENBAUM. You just said to me that is not a vertical merger.

Mr. BAXTER. It is not a vertical merger case. A case does not have to be a vertical merger case in order to undermine a previous case.

Senator METZENBAUM. You know, Mr. Baxter, I honestly believe that you are a person who violates the law and does it with a kind of presumptuousness and a kind of arrogance that is almost unbelievable for an official of the Government.

Mr. BAXTER. I understand that is what you believe.

Senator METZENBAUM. OK, as long as we understand each other.

Let me read you a statement made last month by Richard Favretto when he was Deputy Assistant Attorney General:

> There was clear judicial precedent, of which I am sure you are aware, to the effect that resale price maintenance is illegal per se. Simply stated, the Division's current position on resale price maintenance is to the contrary.

I take it that represents the Division's position. Is that correct?

Mr. BAXTER. No. That seems to me a very unfortunate phrasing of it. It is not at all clear that vertical price maintenance is illegal per se. We had a long period of time when we had the fair trade laws on the books, and the clear implication of those is that when one engaged in vertical price maintenance outside the scope of the permissive language of the fair trade statutes, the conduct was regarded as illegal.

Senator METZENBAUM. Wasn't that repealed in 1975?

Mr. BAXTER. That was repealed in 1975, and the question is where that left the law on vertical price fixing. The best information we have on that of which I am aware is the Supreme Court's decision in the *GTE-Sylvania* case, where the majority really explicitly declined to discuss the practice or to characterize it as illegal per se or otherwise. There was some discussion between the

majority and the dissent about that topic but it left the law in a rather ambiguous state.

Senator METZENBAUM. Are you totally overlooking the *Midcal* decision in 1980? Didn't that address itself to the issue?

Mr. BAXTER. The *Midcal* case is a very difficult case to deal with. One does not know where the agreement in *Midcal* was. We were dealing there with a State statute which ordained a pattern of prices, and it is perfectly true that the Supreme Court struck it down.

Senator METZENBAUM. Senator Gorton described your policies on mergers and resale price maintenance this way:

> The administration is saying that it is its intent unilaterally to retreat from this congressional policy, without bothering to amend the current laws or to consult with the Congress. Its statements amount to a signal to the business community that violations of current law will be tolerated in certain areas, a signal that they have already been received and acted upon.

Isn't that exactly what you are doing, or do you think Senator Gorton was wrong in making that statement?

Mr. BAXTER. No; I do not think that is an accurate characterization.

Senator METZENBAUM. Do you think he was wrong?

Mr. BAXTER. I do not think it is an accurate characterization.

Senator METZENBAUM. Well, that makes him wrong.

Mr. BAXTER. I do not think it is an accurate characterization.

Senator METZENBAUM. I thought I heard you say that once before.

Mr. BAXTER. I think you did.

Senator METZENBAUM. You told Senator Specter at your confirmation hearing:

> I think there are a number of Supreme Court decisions that really do not make much sense because of our tendency to focus on the verticalness or the conglomerateness, and to try to build doctrine around that corporate strength feature rather than confining ourselves to examining the horizontal consequences in particular markets.

Now Mr. Baxter, whether they make sense or not, as a member of the executive branch isn't it your job to carry them out?

Mr. BAXTER. It is my job to carry out the patterns of decision of the Supreme Court interpreting the statutes of Congress as best I understand them. That is correct.

Senator METZENBAUM. According to your testimony here and before the House Monopoly Subcommittee, you say that among the factors under consideration are the rate of technological change, the amount of capital which must be put at risk to enter the market, the stability of relative market shares over time, the disability and restorability of the product, and the growth rate of sales in the individual market and related markets.

I guess we both could agree on one point: Those factors are ambiguous and very hard to measure or even figure out, aren't they?

Mr. BAXTER. The effort to quantify them in a way that gives them sufficient objectivity to be incorporated in useful guidelines is one in which we are presently engaged. It is not easy in the case of all of them, that is quite true.

Senator METZENBAUM. Don't they actually call for an almost totally unstructured inquiry, and add new factors into the antitrust

question that have never before been included, certainly as a group and some of them not even on an individual basis?

Mr. BAXTER. Some of them not even on an individual basis, I think that is quite right. If one did no more than list them in those general terms, without any guidance as to how they would really be incorporated into the analysis or how much they mattered or at what levels of concentration they would be taken into account as tipping factors, I would think one had committed very much the same error that the *Brown Shoe* Court committed in the early sixties in simply throwing out a very large category of things to be taken into account.

As I indicated in my testimony today, I think that gives rise to enormous uncertainty and almost total subjectivity. If we cannot do better than that, we will not incorporate them into the guidelines.

Senator METZENBAUM. Therefore, then, there may be no guidelines.

Mr. BAXTER. No, no. There will be guidelines but those factors will not be present in them.

Senator METZENBAUM. Now Mr. Bork is reported to have said at the August 1981 ABA meeting that the Division merely seeks to jettison all cases that are contrary to sound economic theory. Would you say that is a fair statement of your policy?

Mr. BAXTER. I am sorry. I did not hear it. Would you read it to me again? This is Mr. Robert Bork speaking?

Senator METZENBAUM. Robert Bork: "That the Division merely seeks to jettison all cases that are contrary to sound economic theory."

Mr. BAXTER. I do not doubt that Mr. Bork said that. In some context I gather he was complaining that we had not thrown out enough.

Senator METZENBAUM. No, no. I am asking you, would you say that that is similar to what you have said?

Mr. BAXTER. Taken out of context, I have very little idea what it means.

Senator METZENBAUM. Doesn't it seem to speak for itself—that the Division is attempting to deep-six any case that does not agree with sound economic theory as interpreted by you or somebody else at your Department?

Mr. BAXTER. It says that we are merely trying to do that, which suggests Mr. Bork thinks we should be doing something rather more extreme.

Senator METZENBAUM. Do you think you should do something more extreme?

Mr. BAXTER. No, I do not.

Senator METZENBAUM. Pardon?

Mr. BAXTER. No, I do not.

Senator METZENBAUM. Do you think that you ought to jettison all cases that are contrary to sound economic theory?

Mr. BAXTER. Only to the extent that the statutes and cases on the books authorize us to embody economic theory in our behavior.

Senator METZENBAUM. That so-called sound economic theory has not as yet ever been accepted or recognized by the Supreme Court, has it?

Mr. BAXTER. Oh, on the contrary, there are long portions of a number of recent opinions that discuss it at some length. The Supreme Court has really come a long way in its own views in terms of the centrality of economic theory and the appropriate interpretation both of section 1 and of section 7.

Senator METZENBAUM. Would you tell me some of the cases in which they have said that you can decide a case solely based upon their perception or your perception of sound economic theory?

Mr. BAXTER. I do not think they have ever phrased it that way.

Senator METZENBAUM. Oh, so they really have not phrased it in those terms?

Mr. BAXTER. Not in those terms.

Senator METZENBAUM. How many suits have you filed that were not started by your predecessors?

Mr. BAXTER. I do not know the count. I would guess that the number may be 20.

Senator METZENBAUM. You have filed 20 cases or started 20 investigations?

Mr. BAXTER. You asked a question about filing cases a moment ago. Are you talking about starting investigations?

Senator METZENBAUM. Filing cases based upon the work that has been done since you have come into office.

Mr. BAXTER. That is a harder number. I do not know exactly when the work got done. I think the number would be about 20 cases filed since I came here. The number that have been filed on the basis of work no part of which was done previously?

Senator METZENBAUM. Pardon?

Mr. BAXTER. Work no part of which was done previously, is that what the question means?

Senator METZENBAUM. Well, basically that your office has put together. There may have been some work done before but what I am really asking is, how many cases have you filed—and I want to exclude those that I call the bid-rigging cases——

Mr. BAXTER. You want to exclude those?

Senator METZENBAUM. Yes. Without those, have you filed any?

Mr. BAXTER. Oh, yes, half a dozen, a dozen, something of the sort.

Senator METZENBAUM. Can you name some?

Mr. BAXTER. *Conoco-Du Pont,* a number of cases involving the construction industry——

Senator METZENBAUM. Aren't the bid cases in the construction industry?

Mr. BAXTER. I beg your pardon?

Senator METZENBAUM. Aren't those the bid cases, in the construction industry?

Mr. BAXTER. No, they are not roadbuilding cases. There are others involving levee construction, airport construction, a wide variety of——

Senator METZENBAUM. Would you be good enough to provide us with a list of the nonbid rigging cases, and of course we all know that in the *Du Pont-Conoco* case nothing came of it, so that——

Mr. BAXTER. Nothing came of it? A $270 million divestiture came of it.

Senator METZENBAUM. Oh, of course. I am sorry, You are correct. I stand corrected. That was, let's see, an $8 billion merger. You re-

quired them to divest themselves of about $270 million in total assets. Is that it?

Mr. BAXTER. I think $8 billion is wrong. I recall $6 billion, but——

Senator METZENBAUM. Was it $7.6 billion?

Mr. BAXTER. That is certainly a number in the right order.

Senator METZENBAUM. Whatever the figure is, let the record state the accurate figure and you can supply it.

[The following material was subsequently supplied for the record.]

E. I. du Pont de Nemours & Co., Inc. purchased the stock of Conoco, Inc. for approximately $7.8 billion. Du Pont agreed to purchase assets from Monsanto Company, constituting Monsanto's share of a joint venture with Conoco, for a minimum of $275 million, plus any additional compensation agreed upon by the parties at a later date.

Mr. BAXTER. It was less than 10 percent.

Senator METZENBAUM. Less than 10 percent?

Mr. BAXTER. Ten percent would have been $600 million.

Senator METZENBAUM. Therefore, really we are talking about $270 million as against $7.6 billion. I guess my mathematics gets me about 3 or 3.5 percent.

Mr. BAXTER. No, I do not think my $270 million was right, actually. In any event, it is the right order of magnitude.

Senator METZENBAUM. Not a matter of great magnitude, is that what you said?

Mr. BAXTER. No, an enormous magnitude, but in proportion to the total value of the transaction it was less than 10 percent, around 5 percent.

Senator METZENBAUM. A few years ago you said you would like to see the continued development of a line of business reporting. Despite its difficulties, you said that was an effort that goes very much in the right direction. Do you approve of the FTC's recent decision, reported in this morning's paper, to suspend the line of business reporting, reportedly to take a breathing spell, since their decision obviously flies right in the face of your comment of a few years ago?

Mr. BAXTER. I thought the line of business reporting activity was a useful endeavor. I have not talked with those who made the present decision. I do not know what their reasons were. I could hardly have a firm view on the rightness or wrongness until I heard what their reasons were. I do think the line of business reporting endeavor was potentially quite useful.

Senator METZENBAUM. I have no further questions, Mr. Chairman.

Senator SPECTER. Mr. Baxter, just one or two more questions. I wanted to pursue the inquiry about the decisionmaking process that I cut short to move on to give others an opportunity to question. That relates to the decision on the *A.T. & T.* case.

Wasn't the Cabinet Council involved in the move that you made to seek an 11-month continuance after the Government completed its case?

Mr. BAXTER. Yes, I think one would have to say it was involved. There was a good deal of discussion at a Cabinet Council meeting about whether the pendency of the case was creating a serious

roadblock to the movement of telecommunications legislation through the Congress. A number of people were convinced that it was.

I was not convinced one way or the other myself. I do not regard myself as having a great deal of expertise as to what is facilitating or interfering with the passage of legislation, but under the circumstances it seemed to me appropriate, since that seemed to be the view of a number of people in the administration, to see if the case could not be moved aside temporarily. I certainly would have thought dismissal was totally inappropriate but it did not seem to me inappropriate to see if the case could be continued, since a number of them thought that would facilitate passage of the legislation.

Senator SPECTER. What experience had anyone else in the Cabinet Council had on a deferral of litigation so that some legislative end could be served?

Mr. BAXTER. I have no idea of the answer to that question, Senator. You would have to ask the other people who are members of that Cabinet Council.

Senator SPECTER. Well, you were deferring to their judgment, saying that they knew something or suggesting that they knew something that you did not know.

Mr. BAXTER. They certainly were of the view that they did, and——

Senator SPECTER. They were of a view to seek a continuance so that they could, as they thought, help the legislative process——

Mr. BAXTER. Yes.

Senator SPECTER. But what do they know about a continuance for 11 months?

Mr. BAXTER. I really do not know, Senator.

Senator METZENBAUM. Mr. Chairman, could I interrupt for 1 minute?

Senator SPECTER. Surely.

Senator METZENBAUM. I am going to have to leave but in view of the hour, and in view of the fact that Mr. Miller has just made some rather strong statements within the last 24 hours, on behalf of the minority I would like to request that the hearing be continued until a later date when Mr. Miller would return. If you would have no objections to doing that, I think it is rather late to start with a witness of his prominence here.

Senator SPECTER. Senator Metzenbaum, I would have no objections but I am not the witness.

Is Mr. Miller here?

While we are awaiting Mr. Miller, Senator Kennedy had requested an opportunity to submit additional questions in writing and Senator Metzenbaum has made a similar request. I think as you know, Mr. Baxter, that is the committee's procedure, so those questions in writing may be forthcoming and we would appreciate your response.

Mr. BAXTER. Surely, Senator.

Senator SPECTER. While he is coming, we can proceed with some questions.

Wait just a minute. He is right around the corner.

Mr. Miller, a question has arisen: In view of the lateness of the hour, it is Senator Metzenbaum's request that we not begin with your testimony this afternoon and I am reluctant to impose upon you, knowing that you have been here since we started this proceeding this afternoon, since close to 2 o'clock.

Mr. MILLER. Yes.

Senator SPECTER. Would it be agreeable with you to come back on another occasion?

Mr. MILLER. Yes. I do not know my calendar and what sort of constraints I would be under, at this moment.

Senator SPECTER. Well, we can work that out as to timing but we are sorry that we have kept you. However, it was not possible to tell. We were delayed 30 minutes at the start, and another 20 minutes——

Mr. MILLER. A vote, I understand.

Senator METZENBAUM. I want to say if the chairman wanted to go forward with Mr. Miller this afternoon I certainly would have no objection to doing that, whatever is convenient for you and Mr. Miller.

However, I know several of the members of the minority would like to inquire of you, and I know you have just come out with some new statements less than 24 hours ago. We had better give them a chance to digest those. We appreciate your cooperation.

Senator SPECTER. You may be able to come out with some more statements between now and then, and quite probably will. [Laughter.]

Mr. MILLER. Mr. Chairman, I am delighted to be of assistance to the committee and I will be delighted to respond to any questions you have. I have an appointment with a Congressman but I think I could reschedule that, and I could continue on this afternoon if that would be your pleasure, or I would be glad to try to schedule—I just do not know what kind of conflicts I would have in Commission meetings over the next few days but——

Senator SPECTER. We will see that it is scheduled from this committee at your convenience but since you will be coming back, I think it preferable to begin afresh. If you do not, and you were to proceed with your opening statement, it is highly likely that some of the others would be going over the same ground. That being the case, we will not call on you this afternoon and you are free to go. The hour is late, 4:47.

Mr. MILLER. OK. Thank you, sir.

Senator SPECTER. Thank you very much.

Mr. Baxter, for perhaps more than a few more minutes, since we do not have any constraints closing in, wasn't there pressure in the Council to drop the *A.T. & T.* suit with the 11-month continuance idea being really your counterproposal?

Mr. BAXTER. I think that would be a fair characterization.

Senator SPECTER. What business does the Council have in becoming involved in the mechanism or the processing of a pending litigation matter, especially one as complex as this *A.T. & T.* suit that had been going on for 7½ years?

Mr. BAXTER. Well, I think very little, quite frankly, and when I expressed that view I think they were quick to recognize that. On the other hand, it is also true—as I have said earlier—that this liti-

gation has the potential of significantly affecting the entire future of an entire industry that is of almost incomparable importance to the United States.

Since I think it is entirely appropriate, indeed, it would be a gross neglect of the President's duty if he were to pay no attention or take no concern about the future of that industry, a problem of great delicacy is posed for the administration: How does the administration exercise its entirely appropriate concern about the future of this industry, while at the same time keep its hands off, as it ought to do, of this particular piece of legislation?

Senator SPECTER. I agree with keeping its hands off, but I would think that it would be keeping hands off of the case.

Mr. BAXTER. Excuse me. I said legislation; I meant case. Forgive me.

Senator SPECTER. That is the only part of your last answer that I really agree with. I sense that you were placed in a very difficult if not impossible situation with those seeking to influence the handling of a case for perfectly good motives but not being lawyers, or if lawyers, not being involved in that case, not being charged under the law with being in the Justice Department, and really sort of grasping at straws.

What valid reason was there to think that the Congress would be influenced in its decisionmaking process or voting on the legislation if the case were dropped, or if the case continued, or whatever?

Mr. BAXTER. Well, I think that other witnesses from the administration have explained their answer to that question on several occasions. I recall hearing the Secretary of Commerce do so to this committee several months ago.

Senator SPECTER. I was not here and have not read or heard of his answer. Would you repeat it for me?

Mr. BAXTER. Well, as best I recall his answer—and I am sure he can put it much better than I am now able to put it—it was that the pendency of the litigation in his view was likely to give rise to a joint sequential assignment to committees in the House that would slow the process down very substantially. It was his view, as he expressed himself, that if the case were in recess or perhaps dismissed, that that joint referral would not occur and that the legislation would move more quickly. Now that is simply my best effort to recall his statement at the time.

Senator SPECTER. Are you able to say why he concluded that a joint sequential assignment would result from the continuing trial of the case?

Mr. BAXTER. I believe that that was his interpretation of events that had occurred in the prior session of Congress.

Senator SPECTER. That was in the House, not in the Senate——

Mr. BAXTER. In the House.

Senator SPECTER. Because in the Senate we had an issue whether the matter would be jointly referred to the Committee on the Judiciary as well as to the Commerce Committee.

Mr. BAXTER. However, simultaneous referrals were——

Senator SPECTER. Yes. That came up in the Senate and there was a vote on a related measure in an unusual confrontation and the Commerce Committee retaining exclusive jurisdiction.

Mr. BAXTER. Yes, I understand. The Secretary's impression was that the situation was otherwise in the House.

Senator SPECTER. Therefore, if there had been a joint referral what difference would that have made?

Mr. BAXTER. It was his view—I must admit I am uncomfortable talking about his view; I would prefer that you get his view from him—but it was his view that a joint sequential referral would slow down the process considerably.

Senator SPECTER. Did someone make the argument that the Congress would be very interested in the findings of Judge Green in the case, and that the processing of the litigation could be very helpful in giving the Congress a better feel and perhaps expediting the congressional action?

Mr. BAXTER. I am uncomfortable discussing the precise content of discussions that occurred at the Cabinet Council level, Senator, but I would say yes, those points were made.

Senator SPECTER. Well, the point of importance, Mr. Baxter, is the firm statement of the law about the litigation being your responsibility, the Justice Department and you as the Assistant Attorney General, in light of the fact that the Attorney General had taken himself out of the case. There were many of us in the Senate who were very concerned about the proposals for dropping the case or for an 11-month delay, because it is a very important industry.

That case comes to grip with major segments of the industry and there had been enormous investment in time and effort, and I think we were all entitled—the American people and the Justice Department and the Congress, the whole country—entitled to see how the case would come out. Many of us felt that there was absolutely no bearing of the pendency of the case complicating the life of the legislation.

Mr. BAXTER. I understand that that was a view on which there was a great deal of division, and I myself neither have, nor at any point ever took a point of view on that issue. I just do not regard it as a topic about which I have any expertise whatsoever.

Senator SPECTER. Well, is the role of the Council over insofar as antitrust policy is concerned?

Mr. BAXTER. I hesitate to say it is over because that would imply that there was a point in time when they thought the handling of the case, other than in this very incidental respect as bearing on the legislation——

Senator SPECTER. I will rephrase the question: Does the Council have any current or prospectively future role in antitrust policy?

Mr. BAXTER. Oh, in antitrust policy I should certainly think they might well. That would be a topic that fell very much within the jurisdictional boundaries of that Cabinet Council, and they might well be making recommendations to the Congress. However, I think the administration is very, very sensitive to the importance of drawing a line, which is very difficult to draw, between legislative and administrative policy with respect to the telecommunications industry on the one hand, and the handling of the case on the other. I think there is, will be, and for the most part has been, an extremely careful observation of that line.

Senator SPECTER. How are you going to draw the line on antitrust policy as issues arise on the myriad of considerations which

have been discussed here today, concerning your responsibility, the Department of Justice's responsibility, and the intervention of anybody from the Cabinet Council?

Mr. BAXTER. Well, I think that as to current enforcement policies, they would not suppose that anyone other than the Justice Department ought to be playing an active role. However, as to a wide variety of matters bearing on antitrust policy—for example, the contribution draft which I sent up to this committee a few weeks ago on newly proposed legislation—I would think that that and many other aspects of antitrust policy were entirely appropriate matters of attention for the Cabinet Council on Commerce and Trade.

Senator SPECTER. Well, how do you draw the line between the policy which you have just characterized and the decision on what to prosecute?

Mr. BAXTER. In general I think that is a very important line, an easy line to draw, and a line that has never been transgressed in this administration. If it had been I would be in a position to know.

The only context in which that process becomes at all complicated is where you have a case of such magnitude and with such import to the entire future of an industry that it becomes difficult to separate at least the remedy phase of the case from the entirely appropriate concern of the administration with policy toward that industry in the future.

Senator SPECTER. However, Mr. Baxter, what you are doing is, you are in effect singling out one case because it is so important. Isn't that precisely the kind of case in which the regular rule ought to apply, that it is only a Justice Department function and nobody else's business?

Mr. BAXTER. I would think that if this case were a case against the A.T. & T. Co. for damages or for a civil penalty or to put somebody in jail, that you would be 100 percent right, but what this case is about is restructuring the A.T. & T. Co. and therefore restructuring what arguably is the most important industry in the United States.

Senator SPECTER. Does the issue of obstruction of justice reach the line of remedy? Is it different if it is a criminal penalty sought, or damages, or injunctive relief?

Mr. BAXTER. I think one would have to make a distinction along those lines, yes.

Senator SPECTER. Where is that clear line, if you can define it, which separates the kind of policy in which the Cabinet Council has an appropriate role in and the decision to prosecute an antitrust violation?

Mr. BAXTER. In any ordinary case, once the infraction has been drawn to the attention of the Justice Department, the incident has been drawn to the attention of the Justice Department, and we commence an investigation with the possibility of applying to that incident the law and policy as it has been up until this point in time, I would regard that as entirely and exclusively a matter for the Justice Department.

Senator SPECTER. However, the grave problem is that you have just defined "when an infraction occurs," and the whole bulk of your testimony for several hours this afternoon is that infraction

turns upon formulation of policy, which turns upon a very complex set of economic factors and many variables, which sounds to me as if it is right in the lap of the Cabinet Council.

Mr. BAXTER. I think it is quite appropriately in the lap of the Cabinet Council with respect to the prospective formulation of antitrust policy in general as opposed to applied to individual cases.

Senator SPECTER. Well, would you make the distinction that the Cabinet Council would not take up any individual circumstance in the formulation of the policy but would only talk in general, and would not be familiar with what goes on with any specific case, but that would be the province of the Justice Department?

Mr. BAXTER. Oh, I certainly would agree with that proposition. Indeed, if anything it seems to me too narrow. However, the *A.T. & T.* case on the other hand seems to me to pose enormously difficult problems, precisely because of the nature of the remedy which is being sought in that case.

Senator SPECTER. You do not think that the *A.T. & T.* case is clearly on the side of the line that the Cabinet Council has no business in it, even under your definition?

Mr. BAXTER. I think that the liability aspects of that case——

Senator SPECTER. Do you separate between liability and remedy? The Cabinet Council would have had no appropriate function to decide whether the case should be brought, that is, as to the issue of liability?

Mr. BAXTER. Yes.

Senator SPECTER. It would have an appropriate role to decide what remedy should be sought?

Mr. BAXTER. I simply say that given the remedy the Justice Department chose to seek in that case, one cannot regard the case any longer as being wholly untouchable by other portions of the administration. It simply has the potential for transcending the range of Department of Justice responsibility.

Senator SPECTER. What if the decision were made by the Cabinet Council that there should be no remedy?

Mr. BAXTER. I would not regard that as an appropriate decision by the Cabinet Council.

Senator SPECTER. However, that is within the purview of the delineation you have made. You have made the delineation that liability is a Justice Department function, remedy is a Cabinet Council function.

Mr. BAXTER. No, I did not say that remedy was a Cabinet Council function. I said given the particular remedy we have chosen to seek, which would restructure this industry for the indefinite future, the cleanness of the line that can be drawn and should be drawn in other contexts is far more difficult here.

Senator SPECTER. Do you know whether the Cabinet Council has ever expressed any opinion at all on a pending case, as they did on the *A.T. & T.* matter?

Mr. BAXTER. I believe the Cabinet Council vehicle—and I speak as a total neophyte about the Federal administrative branch——

Senator SPECTER. We have a very small club here. You are in equal company.

Mr. BAXTER. I believe that is an institution that is unique to this administration.

Senator SPECTER. Well, never mind the Cabinet Council as it is currently defined. Has anybody in the Department of Commerce or any other of the executive agencies ever taken such a position on a pending antitrust case, to your knowledge?

Mr. BAXTER. Well, I can think of several cases where they did and it was thought quite inappropriate, but I——

Senator SPECTER. It was inappropriate?

Mr. BAXTER. I say they were thought to be quite inappropriate.

Senator SPECTER. I would think so.

Mr. BAXTER. On the other hand, I suspect if one went back to the eve of World War II when the question of breaking up Alcoa Aluminum was in the hands of the courts following Judge Learned Hand's opinion in that case, with the aviation industry obviously going to be dependent upon the stability of aluminum production in the United States, I would be amazed if the administration, the Defense Department had had nothing to say about the remedy that was being sought in the *Alcoa* case. I do not cite that to you as an example because I have no idea what happened at that date in time——

Senator SPECTER. You are just speculating now.

Mr. BAXTER [continuing]. But I would speculate.

Senator SPECTER. That might come under the national defense exception, even so.

Mr. BAXTER. And so might this.

Senator SPECTER. The wartime exception.

Mr. BAXTER. Well, this would not be a wartime exception, but the problem surely cannot be regarded as a matter of total indifference to the Defense Department.

Senator SPECTER. Well, but not being a matter of total indifference does not give them any standing to participate.

Mr. BAXTER. Certainly not to participate.

Senator SPECTER. Well, that is a very complex matter which I think we have just scratched the surface on this afternoon but I have some continuing concern, given the vagaries of what is antitrust policy, what it necessarily must be, to ponder from where the judgments are coming as to what the antitrust policy is.

However Senator Metzenbaum may characterize your attitudes, Mr. Baxter, he at least knows whose attitudes they are. If there are many others in the picture making antitrust policy, that is disquieting. We do not know whom to call before this committee.

Mr. BAXTER. Well, there are not. The Attorney General and the Deputy, of course, are entirely appropriate formulators of antitrust policy——

Senator SPECTER. Certainly.

Mr. BAXTER. And I can assure you with the exception of the isolated incident that we have been discussing, namely the decision to seek that continuance, there has been no attempt whatsoever by anyone in the administration to influence the formation or the application of antitrust policy.

That particular incident seems to me to have characteristics quite unlike those involved in the routine course of antitrust enforcement, which create a problem of extreme delicacy for the administration, one which I think was handled as well as could be under the circumstances.

Senator SPECTER. I have good news for you, Mr. Baxter. There is another vote. You have been very patient and the committee appreciates your being here.

One final question or line of questioning, and that is, going back to the situation with Conoco, when Mobil made its tender and made certain submissions to the Justice Department, there was a request made for additional information. While that was in process, the Du Pont-Conoco merger was consummated. My question is, wasn't the prospective merger of the No. 2 oil company, Mobil, with the No. 9 oil company, Conoco—given their sizes and market shares and the complexities of oil—sufficient on its surface that a merger between those two giants would have been violative of the antitrust laws?

Mr. BAXTER. No, I do not believe it was, Senator. In the first place, their size seems to me a matter of irrelevance. I do not know what you suppose their market shares were but we looked at their market shares in at least 20—I am guessing at the number—but something upward of 20 separate product and geographic markets. We did not have all the information we would have liked to have had as to some of those markets, and accordingly, we asked for more. However, in the markets with respect to which we did have adequate information, there were very few that exhibited a high level of concentration.

Senator SPECTER. What were you looking for, Mr. Baxter?

Mr. BAXTER. Oh, for example, we were looking——

Senator SPECTER. I mean what share of markets were you looking for before there would have been an antitrust violation?

Mr. BAXTER. Well, I would say the first question was the level of concentration that characterizes the market without respect to the market shares of these individual companies. Most of those markets were not highly concentrated—four-firm concentration ratios in the neighborhood of 34, 35, 40, 45 percent—and in many of the markets, the shares of the two companies would be 7 percent and 4 percent or 8 percent and 2 percent.

In short, it was not easy to come by markets where there was a significant degree of concentration and where each of these companies had a significant market share. I do not mean to say there were not any. We were still looking. There were markets——

Senator SPECTER. Do you recall the market shares in the *Philadelphia National Bank* case?

Mr. BAXTER. The market share in the *Philadelphia National Bank* case was extremely high. As I recall, one of the banks had about 26 percent of the market and I think the other had 17 or 18, so that the aggregate of their two market shares came to 42 or 45 percent, and the four-firm concentration ratio, as I recall—it was 17 years ago—was 75 percent or something like that. In short, the outcome of the *Philadelphia National Bank* case could hardly have come as a surprise to anybody. What came as a surprise to people about the *Philadelphia National Bank* case was the articulation it took.

Senator SPECTER. Therefore, you think it entirely conceivable that Mobil-Conoco could have passed antitrust muster?

Mr. BAXTER. One obviously has to be very nervous and look with extraordinary care at a merger that involves horizontal overlaps in as many different markets as that merger did.

Senator SPECTER. Notwithstanding all of the guidelines and all of the rules and all of the refinements, it was my instant response that that would be a case that could not have possibly passed antitrust muster; that it would be one which would necessarily fall, given all of the factors and circumstances, but I did not put it under the microscope as you did.

Mr. BAXTER. Well, we did put it under the microscope and we never finished examining it under the microscope because the matter became moot.

Senator SPECTER. Therefore, it is possible that it might have passed antitrust muster?

Mr. BAXTER. I cannot rule out that possibility but I have no hesitation in telling you that with as many markets involved as there were, I viewed it as a matter of great concern, and we were looking at it very, very carefully and sceptically.

Senator SPECTER. Were you not displeased to find the problem evaporate by an alternative acquisition by——

Mr. BAXTER. I would be hard put to tell you that I was displeased.

Senator SPECTER. Mr. Baxter, we appreciate your being here. Thank you very, very much.

Mr. BAXTER. You are welcome.

Senator SPECTER. The hearing is adjourned.

[Whereupon, at 5:15 p.m, the committee recessed, to reconvene at the call of the Chair.]

[Prepared statement of Hon. William F. Baxter follows:]

Department of Justice

STATEMENT

OF

WILLIAM F. BAXTER
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE

THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

MERGER POLICY

ON

OCTOBER 27, 1981

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss with you the Department of Justice's policy regarding mergers. I have repeatedly stated that one of my priorities as Assistant Attorney General in charge of the Antitrust Division is to clarify the Department's enforcement intentions in this area, and I hope my appearance here today will add to that clarification.

As you know, the primary statute applicable to mergers and acquisitions is Section 7 of the Clayton Act, which prohibits transactions which may substantially lessen competition or tend to create a monopoly in any line of commerce in any section of the country. I refer to Section 7 because it represents the latest authoritative legislative articulation of merger standards, but in referring to Section 7 I do not mean to suggest that Section 1 of the Sherman Act, as it is and should be interpreted in light of Section 7's passage, imports any greater, lesser or different standards.

This statutory language then, of Section 7 or of Section 1, requires analysis as to whether the particular merger or acquisition under consideration threatens a significant lessening of competition in a specific market; that is, whether it creates a significant potential for adverse horizontal effects in any such market. This analysis requires a careful review of each transaction to determine the parameters of the affected market and to predict as accurately as possible the likely effect of the proposed transaction on competition in that market.

In my view, the evolution of the law over the past twenty or so years has been confusing and often confused. In its well-known Brown Shoe decision, 1/ the Supreme Court emphasized the need for analysis of a wide variety of factors but, unfortunately, rendered no practical guidance as to how the many specific factors should be evaluated and weighted in reaching the ultimate conclusion. I strongly suspect that, as a result of the vagueness of that decision, judges in subsequent merger cases, after endeavoring to cope with the totally unstructured inquiry suggested by Brown Shoe, decided to place primary emphasis on simplified assumptions about the competitive effects of transactions they were called upon to review. Certainly it is true that after the Supreme Court's opinion in 1963, in Philadelphia National Bank, 2/ judicial analysis has been confined almost exclusively to levels of market concentration and the market shares of the combining firms. However, such analysis largely reflects, I believe, the static structuralism found in the economic literature of the 1930s and 1940s pertaining to competitive behavior and concentration, as well as a desire to simplify the analysis of such transactions for reasons of judicial economy.

The industrial organization literature has become far richer and more sophisticated since those early years, and it has become

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1/ Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

2/ United States v. Philadelphia National Bank, 374 U.S. 321 (1963).

increasingly clear to economists and legal scholars that some of the simplified assumptions relied upon by the courts have been applied with unwarranted enthusiasm. The courts, too, during the last six or seven years have begun gradually to turn away from rigid adherence to set numerical formulae confined to market concentration and market share factors in favor of a desirably broadened analysis, permitting consideration of additional factors relevant to the realistic assessment of the likely competitive effects of any proposed transaction. For example, in the General Dynamics case, 3/ the Supreme Court held that while historic market shares alone may establish a prima facie case, the inference of illegality may be rebutted by evidence that past market shares do not accurately reflect present and future competitive conditions in the relevant market. The Court has also emphasized the need for establishing realistic market definitions, and has required evidence that expansion through acquisition into a market where a firm has not previously competed actually poses a threat to competition in that market. 4/

The merger enforcement policy of the Department of Justice has generally followed the evolution of the law in this area. As a result, the Antitrust Division has concentrated its efforts

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3/ United States v. General Dynamics Corp., 415 U.S. 486 (1974). See also United States v. Citizens & Southern National Bank, 422 U.S. 86 (1975).

4/ United States v. Marine Bancorporation, Inc., 418 U.S. 602 (1974).

in recent years on mergers that could adversely affect horizontal competition. Concommitantly, vertical and conglomerate merger cases have ceased to be a major enforcement focus of the Division. That is not to say, however, that every merger the Antitrust Division challenges involves firms that are direct competitors. For example, certain mergers may adversely affect horizontal competition even if there is no direct horizontal overlap between the parties to the transaction where potential competition is eliminated. Furthermore, despite the emphasis on market share and concentration data, the Division has not ignored other factors relevant to the analysis of horizontal competitive effects in determining whether to challenge particular transactions.

The Department's merger guidelines were issued in 1968 to help the bar and the business community understand our likely enforcement intentions with respect to mergers and acquisitions. At that time, it was expressly contemplated that those guidelines would be revised to take into account future developments. 5/ Although the Department's enforcement policies have continued to evolve with new economic thinking and judicial interpretations of the Clayton Act, our merger guidelines unfortunately have remained unchanged since they were first published. As a result, they are now substantially at variance with the state of the law, with current economic knowledge, and with the Department's actual enforcement practices. This situation has contributed to confusion

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5/ See, e.g., Department of Justice Press Release, May 30, 1968 (announcing the release of the merger guidelines).

and uncertainty in the business community, and it should be corrected.

Accordingly, we are now devoting substantial efforts to revising the merger guidelines. Through this process, we hope to reduce uncertainty and to bring the Department's published enforcement standards into line with the current state of economic knowledge. This revision will have the additional benefits of making the guidelines correspond more closely with current developments in the law and actual Department enforcement practice.

The ultimate goal of our efforts is to develop a concise statement of the analysis that the Department will undertake in assessing the likely competitive effects of a merger or acquisition. The trend in the case law has been toward a more realistic assessment of actual competitive conditions and away from talismanic reliance on a limited set of mathematical indicators. Formulating a manageable set of standards to reflect our analysis is a task we consider essential if we are to provide accurate guidance as to our enforcement intentions in this area.

This process is a complicated and difficult one, and it is still too early for me to describe how the revised guidelines will look. I am reluctant to risk additional and unnecessary confusion by discussing specific formulations that are under review. I can, however, describe some of the issues which we are attempting to incorporate into the analysis. As you know, before the probable competitive effects of any merger can be assessed, the market within which competition takes place must

be defined. Therefore, we are attempting to develop definitions for product and geographic markets that, when applied, will reflect as accurately as possible the actual state of competition in those markets. We are also searching for the most helpful ways of expressing and understanding the structure of individual markets, taking into account such factors as the number and size distribution of firms, including the merging firms. As I have already mentioned, factors other than these concentration data are relevant to the probable competitive effects of a transaction, and we accordingly are attempting to isolate the most important of these and formulate manageable standards incorporating them. Among the factors under consideration are the rate of technological change, the amount of capital which must be put at risk to enter the market, the stability of relative market shares over time, the durability and restorability of the product, and the growth rate of sales in the individual market and related markets. Revised guidelines dealing with such issues should be of substantial assistance to the business community and the antitrust bar, and should deter anticompetitive mergers without unnecessarily deterring transactions that may contribute to productivity, cost reduction and consumer welfare.

Until this process is completed and revised guidelines are published, we will continue to apply the general principles set forth in recent cases, although, to be sure, those cases provide only very limited guidance. We will continue to assess each transaction carefully and individually to determine whether it

poses a threat to competition. I believe this is a sound and responsible approach. While there has been significant merger activity this year, that is not itself a sufficient reason to alter our antitrust enforcement standards or to depart in any way from our present approach of attempting accurately to assess competition within specific and realistically-defined markets.

For reasons that are not fully understood at this time, merger activity appears to be cyclical. The rate of present merger activity certainly is not unprecedented; some statistics indicate, for example, that a more significant merger movement took place in the late 1960s. I might also point out that this movement occurred at a time when merger enforcement was highly visible and based on then-recent and strongly supportive Supreme Court precedent. That fact, it seems to me, casts doubt on assertions that the present movement is attributable to recent policy statements made by representatives of the Department of Justice.

In any event, it is clear that the intensity of merger activity is related to a variety of factors, and that any particular merger may be competitively neutral or highly procompetitive. Thus, it would be inappropriate to attack large mergers generally in response to a perceived merger trend without giving due regard to their competitive effects in individual markets. Such a generalized attack could seriously impair existing capital market mechanisms for ensuring that assets are put to their most productive use. And, indeed, the statutory language of Section 7 precludes any such generalized attack.

In conclusion, the Department of Justice will vigorously and responsibly enforce the antitrust laws against mergers and acquisitions by continuing to scrutinize each transaction with the utmost care, looking for evidence of its probable effects on competition in appropriately defined markets.

Mr. Chairman, that concludes my prepared remarks. I would be happy to respond to any questions you or any other member of the Committee may have.

OVERSIGHT OF GOVERNMENT MERGER ENFORCEMENT POLICY

THURSDAY, NOVEMBER 19, 1981

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The committee met, pursuant to recess, at 1:45 p.m., in room 2228, Dirksen Senate Office Building, Senator Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Specter, Metzenbaum, and Baucus.

Staff present: Steve Cannon, antitrust counsel; Marcy Tiffany, antitrust counsel and chief economist; Peter Chumbris, antitrust counsel; Bruce Cohen, counsel; Mary Louise Westmoreland, counsel; Jack Nash, counsel; Peter Ormsby, counsel; Herman Schwartz, counsel; and Marge Baker, counsel.

OPENING STATEMENT OF SENATOR STROM THURMOND

The CHAIRMAN. The committee will come to order.

The committee today continues its oversight on Government merger enforcement policy. Several weeks ago, this committee received testimony from Assistant Attorney General Baxter, who is in charge of the Antitrust Division of the Justice Department.

This afternoon the committee turns its attention to the antitrust enforcement responsibilities of the Federal Trade Commission. We are pleased that James C. Miller III, the new Chairman of the Commission, is with us today and look forward to hearing from him.

We are also pleased to have with us Dr. Yale Brozen, professor of economics at the University of Chicago.

Dr. Miller, I welcome you on behalf of the committee. I know you are brand new to your position and consequently want to assure you that you will have numerous opportunities to appear before the committee in the future.

Mr. MILLER. Thank you, sir.

The CHAIRMAN. Senator Metzenbaum may have an opening statement.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. I thank you, Mr. Chairman.

Mr. Chairman, in my opinion, vigorous antitrust enforcement is the necessary underpinning to a successful free enterprise system. You do not have competition working in the free enterprise system, in my opinion, unless the antitrust laws of this country are permit-

ted to work. That is not Democratic doctrine; it is not Republican doctrine; it is part of our bipartisan tradition that goes back to 1890. That bipartisan tradition is now being threatened, as many Republican Senators have noted.

I am proud of the fact that my own State of Ohio produced Senator John Sherman, the author of the Sherman Act and a Republican from my State.

Senator Danforth acutely described this administration's attitude toward antitrust enforcement as "downright hostile . . . when it comes to enforcement by the Federal Trade Commission."

That hostility comes at a very inauspicious time. The number of very big mergers involving America's largest firms is climbing. The National Association of Accountants surveyed 480 of the largest industrial corporations in this country, and they concluded that 37 percent of these big companies—37 percent—are seeking mergers or acquisitions. One special point of interest: 49 percent of these huge enterprises consider themselves vulnerable to takeover.

As a consequence of the administration's indifference, the merger pace is quickening. Last year a record $44.3 billion was spent acquiring other businesses. For just the first 9 months of 1981, about $61 billion has already been spent at a pace 33 percent higher than last year. Eight transactions were valued at more than $1 billion each.

The consequences of this great grab are obvious. Scarce capital is used, not for improving productivity, which is so desperately needed, but to reshuffle corporate assets.

Today I sat next to the Republican candidate for Governor of the State of Ohio and heard him addressing himself to these very same concerns about big companies buying up other big companies and talking about the problem of what happens to the availability of capital.

When we are trying to balance budgets, when we are trying to keep from going into the money markets, so that we do not dry up all of the money that is available, corporations in this country have sequestered something in the area of $60 billion for the purpose of making more and more acquisitions, all of which results in higher interest and higher inflation. And small business is squeezed more and more severely.

What are our enforcement agencies doing to stop this? Very little indeed. According to a Dillon, Read partner, in the Wall Street Journal of August 6, 1981, the Government's attitude should spark a 10- to 15-percent increase in merger activity. A clear example of this can be found in today's news that Marathon, an Ohio-based company, has found a "white knight"—United States Steel—to fight the Mobil takeover.

Realistically speaking, there is no reason for anybody to take over Marathon. It is a good Ohio company. It is a well run company. But because of the threat of a Mobil takeover, they go out and try to find the Nation's largest steel company to buy them up. Either way this comes out, the Nation loses. Another independent company goes under, and aggregate concentration increases.

If Mobil had not tried to acquire Marathon, there would not be the certainty of a Marathon absorption by someone else. As a matter of fact, even Wall Street has reacted negatively to Mobil's

efforts in this area, in talking about Mobil "testing the limits," in talking about their being the one that is always willing to go a little bit further than anyone else.

But I cannot get very enthused about the Nation's largest steel company acquiring the 17th largest oil company in this country. If it were not for the permissive signals sent out by the administration, it is highly likely that Mobil would never have even tried.

I think no great satisfaction is to be found in the fact that the steel company—for whom this Congress and this administration have been attempting to provide some protection, some help, some additional dollars so they might add to their technological development of steel to be able to compete with the Japanese and the Germans—wants to spend these billions of dollars—$40 a share more than Mobil offered, and that is good as far as the stockholders are concerned—spending a fortune to buy up an oil company rather than to innovate and compete as Congress intended that they would when we gave them the stretch-out arrangements and when we gave them the tax benefits.

As a colleague in the administration, our witness today seems to view all these events with sublime indifference, especially if the FTC transition team report is any indication.

Of conglomerate mergers, Mr. Miller himself said at a hearing:

> I really do not perceive it to be the role of the Federal Trade Commission to decide that that so-called concentration of wealth or power is excessive * * * so there are efficiencies that can be gained from conglomerate mergers. That is the focus—the economic efficiency.

Apparently our witness today has not bothered to check the legislative history of the four congressional enactments since 1890 or the Supreme Court cases interpreting those laws.

On vertical mergers and agreements, our witness today in the transition team report says as follows:

> The foreclosure argument erroneously assumes that the merger would not result in increased efficiencies * * *. It would seem that agency efforts to restrain vertical mergers are by and large misdirected.

That may be our witness's opinion, but unfortunately he is put into office to enforce the law, and the Supreme Court does not seem to agree with that interpretation. Until Congress decides otherwise, this Senator as well as other Senators on the other side of the aisle have pretty clearly indicated that we think the Supreme Court decides what is the law of the land and that those who are put into office to enforce those laws have an obligation to do just that.

Mr. Miller also does not think much of Robinson-Patman Act enforcement by the Commission. He would apparently limit FTC enforcement to Robinson-Patman Act violations involving horizontal collusion. But that is not at all what Congress had in mind when it passed that statute.

The attitude we can apparently expect from the FTC is expressed, I am afraid, in the following statement by the transition team:

> We believe that, in allocating its scarce resources to various programs and activities, the Commission should be guided by effects of its actions on consumers, or, more explicitly, the effects on economic efficiency. Obviously, this means that a deci-

sion to take issue with a particular business practice transcends the question of legality.

I have to say to our witness, you are a law enforcement official. You are head of an agency of Government. That responsibility also brings with it the obligation to enforce the laws as they have been interpreted by the Supreme Court. But apparently from what you are saying, it is not enough. If something is illegal, it will not be challenged by the Commission unless somehow it is in some unspecified way worse than just illegal. That is hard for me to believe.

This is surely an interesting way to encourage respect for the law, but I think not really. It seems like a perfect illustration of Senator Gorton's comment that:

It would be difficult to imagine a stronger case of the administration unilaterally announcing an intention to tolerate violations of clearly and undisputedly established antitrust laws.

And it is not just antitrust. In consumer protection, Mr. Miller threatens to take us back not only to buyer beware but to that new concept, anything goes.

Here is how Mr. Miller put it in his press conference:

Consumers are not as gullible as many people, as many regulators tend to think they are. They make intelligent choices. The thing that concerns me is that if we are so tight in our regulation that we can only produce the top-of-the-line kind of product because maybe people in Washington, D.C. with high incomes only use top-of-the-line products. Then people who would like to purchase a much lower-priced and perhaps not as high a quality product will be deprived of that opportunity. And I want to make sure that doesn't happen.

That was Mr. Miller's press conference of October 26.

It is so unbelievable in its language—to think that the poor can protect themselves, that the average person does not need some protection—that it just befuddles my mind. Since when do poor people want shabby goods? A consumer may want a Chevrolet, not a Cadillac, but that does not mean he wants a shoddy Chevrolet. And unless there is some Government regulation, the already huge number of consumer complaints will swell even more. Were all these buyers gullible for buying goods that turned out unsatisfactory?

And all of this in the name of an economic theory that is hotly disputed, in the name of economic efficiencies which cannot be proved or measured, and, in all probability, rarely exist. The Wall Street Journal, Forbes, Business Week, the London Economist—all these business papers have reported again and again how poorly the merged companies of this country have performed.

The Mobil-Marcor deal, written up in so many magazines and articles as one of the bloopers of the year from an economic standpoint; the Exxon-Reliance deal, reported on the front cover of Fortune magazine as Exxon's $600 million blunder; the Pan American-National merger, which certainly did not help the riding public, and I do not know whom it did help—these are but a few of the duds. Quoting the Journal, 7 out of 10 do not meet expectations.

A Harvard Business School study documented and analyzed these failures, particularly the vertical mergers, of which Messrs. Miller and Baxter approve so much.

In the face of all this, we are given only a theoretical rationalization for a do-nothing policy. Our Nation deserves better from its top enforcement officials.

I look forward to Mr. Miller's statement describing where he intends to take the FTC on mergers and other problems, why, and how his actions will conform with the laws of our country.

I thank you, Mr. Chairman.

The CHAIRMAN. Senator Specter, do you have an opening statement?

OPENING STATEMENT OF SENATOR ARLEN SPECTER

Senator SPECTER. Thank you, Mr. Chairman.

I have just a word or two. I want to commend the chairman for convening this session, because I think it is very important that this committee exercise its supervisory function with respect to the Federal Trade Commission, and I want to join the chairman in welcoming Chairman Miller here today on a variety of subjects.

I think it is important that we have an evaluation as to where Mr. Miller sees his Commission heading with respect to the budget cuts; an idea as to the formulation of policy with respect to any involvement of the so-called Cabinet Counsel, or any other contacts from the executive branch of the Government; the specifics on the reported tilt to an economic agency as contrasted with a law enforcement agency, without prejudging where Chairman Miller or the Commission may come out on that subject; the subject of his reported comments about imperfect products and responsibility to substantiate advertising claims; and perhaps most fundamentally on the subject of mergers, with appropriate regard to the proposed Mobil-Marathon merger or the substitute United States Steel-Marathon merger, and the subject of mergers generally, being aware of the limitations regarding what Dr. Miller can testify to without tainting any of the proceedings which may come before his agency.

I think those subjects are all very important, I look forward to Chairman Miller's testimony, and I thank the Chair.

The CHAIRMAN. Thank you.

Mr. Miller, again, we are glad to have you with us. You may proceed now with your testimony.

STATEMENT OF HON. JAMES C. MILLER III, CHAIRMAN, FEDERAL TRADE COMMISSION, ACCOMPANIED BY THOMAS J. CAMPBELL, DIRECTOR, BUREAU OF COMPETITION, AND ROBERT D. TOLLISON, DIRECTOR, BUREAU OF ECONOMICS

Mr. MILLER. Thank you, Senator. I appreciate very much the comments of Senator Metzenbaum and Senator Specter. I welcome the opportunity to amplify on my own views and to express them and articulate them here.

Let me simply summarize if I might, Mr. Chairman, the testimony that I have prepared for the committee. I will summarize it briefly.

Before I do that, sir, I would like to introduce the two colleagues I have here at the table with me. To my right is the Director of the Bureau of Competition at the Federal Trade Commission, Thomas J. Campbell. Dr. Campbell has a remarkable record of having

earned a Ph. D. in economics from the University of Chicago, and a jurisdoctor degree from Harvard Law School. He has clerked for a Supreme Court Justice and for another Federal judge. He has practiced law for a private firm, has worked for the Deputy Attorney General, and has also been a White House Fellow. I am very happy to have him at the Federal Trade Commission.

The CHAIRMAN. With all that education, we will have to be careful what we say around here now.

Mr. MILLER. To my left, sir, is Dr. Robert D. Tollison, who is on leave from Virginia Polytechnic Institute and State University. He is a graduate of Wofford College in South Carolina and of the University of Virginia, where he worked and wrote papers together as graduate student colleagues. He has been chairman of the Department of Economics at Texas A&M University. He has taught at Cornell University, has been on the staff of the Council of Economic Advisors, and has been executive director of the Center for Public Choice at VPI. His curriculum vitae includes approximately 12 pages of single-spaced entries of articles and books that he has written on public policy and economics. We are very glad to have him at the Commission.

Senator METZENBAUM. None of those 12 pages means as much to us as the fact that he comes from South Carolina.

The CHAIRMAN. You are a man of such good judgment. [Laughter.]

You may proceed.

SUMMARY OF PREPARED STATEMENT

Mr. MILLER. Sir, what I was asked to address the question of mergers, especially the question of merger enforcement guidelines. Mergers, in my judgment, are very important in the economy. Mergers can be procompetitive as well as anticompetitive. The question that we need to address at the Federal Trade Commission is how to distinguish between those mergers likely to be procompetitive and those that are anticompetitive.

We could have a full-blown investigation of each merger. That would occupy not only all the resources at the Federal Trade Commission, but all the resources at the Department of Justice as well. One solution would seem to be guidelines to direct us into those areas where we are more likely to find anticompetitive-type mergers.

The Department of Justice issued merger guidelines in 1968, and they were based on the current thinking of the time. I can perhaps summarize them as saying that if you have increased concentration in any given industry, you are likely to get monopoly power.

But times have changed. We now have more and better evidence, and we now understand more accurately the cause and effect relationship. We think other factors affect the likelihood of securing monopoly power, such as domestic entry conditions, the possibility of imports from abroad, and competition from substitutes.

I personally applaud the efforts by the Department of Justice to reassess their merger guidelines. As you know, Senators, the Federal Trade Commission is undergoing a very active review of those

merger guidelines, and is putting together its own recommendations.

Merger guidelines in the past have been applied primarily in the horizontal area, although there have been merger guidelines for vertical mergers as well. Let me address a second type of merger, the conglomerate merger.

My feeling is that the antitrust laws should not be used as a blunt instrument to block conglomerate mergers. Some conglomerate mergers—in fact, I would venture to say most conglomerate mergers—result in efficiencies to the economy and do not violate the antitrust laws in any way. Others do not result in such efficiencies.

We must, however, separate the two types of conglomerate mergers. Competition is a very important discipline in making sure that only those conglomerate mergers that are likely to have procompetitive or efficiency effects go forward. Mergers that are not likely to result in efficiency gains simply are not consummated, or the discipline of losses after they are consummated provides a strong incentive to undo them.

There are situations in which conglomerate mergers may tend to create a monopoly, and in those cases we ought to look at them very closely. However, we need to be very careful in allocating our resources at the Commission, to assure that we challenge those kinds of mergers that create the greatest problems. Those, in my judgment, are horizontal mergers.

The third type of merger is a vertical merger. The underlying potentially troublesome characteristic of a vertical merger—that is, an attempt to monopolize—is not as prevalent as it is for horizontal mergers. The prospect of eliminating potential competition has been the strong argument for looking at vertical mergers, and, in fact, is the theory under which the Commission in the past has analyzed that kind of merger.

Vertical mergers can create efficiencies. They should be examined but, again, I do not think the antitrust laws should be used as a blunt instrument to block all vertical mergers.

In conclusion, Mr. Chairman, I assure you that under my leadership the Federal Trade Commission will enforce the antitrust laws with vigor. However, I think we should allocate our resources very carefully to make sure that we do the best job possible for the American people.

Thank you very much.

MOBIL'S PROPOSED ACQUISITION OF MARATHON

Senator SPECTER [acting chairman]. Thank you very much, Chairman Miller.

I am sure you are aware of the intense interest of the Congress in the current attempt by Mobil to acquire Marathon Oil Co. Recognizing the constraints on your comments, this committee would nevertheless like an update of the Commission's actions to the extent that you may permissibly comment about the Mobil-Marathon situation.

Mr. MILLER. Sir, I will be happy to.

Could I ask you this as a matter of procedure? Senator Metzenbaum raised a number of issues. I would like to have an opportunity to respond to them. He may wish, or you may wish, sir, to do that later or not at all.

Senator SPECTER. I am sure you will have an opportunity to respond to them.

Mr. MILLER. Fine.

I will address, sir, your question on the status of the Marathon-Mobil merger. When we received on a Friday afternoon, across the ticker, notice that Mobil had tendered an offer to acquire Marathon, Dr. Campbell brought it to my attention immediately. We agreed to look into the matter very expeditiously and to contact the Department of Justice.

Several telephone calls transpired, and it was decided that the Federal Trade Commission, pursuant to a policy established over a period of several years, would handle this case, since it is a petroleum case.

Senator SPECTER. Procedurally, how is the division made as between Justice and the Federal Trade Commission?

Mr. MILLER. There is a liaison agreement between the two agencies providing that only one of the agencies will take a particular case, and usually it falls to the agency with the most expertise in the area. We felt that we had the greater expertise in this situation.

Senator SPECTER. Did Justice concur that you had more expertise than they?

Mr. MILLER. Justice concurred that we should take the case.

Senator SPECTER. Under what standard? Did they agree with your expertise standard, or was it some other standard?

Mr. MILLER. Well, sir, they may have agreed with that. I would not want to commit Mr. Baxter at this point. I told Mr. Baxter, as did Mr. Campbell, that we wanted to take this case, and we thought we had the relevant expertise—in fact, superior expertise—on this matter.

Senator SPECTER. You had the discussion with Mr. Baxter?

Mr. MILLER. I had a discussion with Mr. Baxter, and Dr. Campbell also had a discussion with Mr. Baxter on the matter.

Senator SPECTER. When you said that to Mr. Baxter, what did he respond to you?

Mr. MILLER. He took all those things into consideration in making up his mind not to protest my initiative to investigate the matter.

Senator SPECTER. Aside from what he considered, which you may or may not know, what did he say to you?

Mr. MILLER. He did not say anything on the matter of expertise that I can recollect.

Senator SPECTER. Did you and he discuss any of the standards which would apply to whether your agency or his Department would undertake the matter?

Mr. MILLER. We did not discuss which agency would more likely——

Senator SPECTER. You simply said to him, "I think we have the expertise in the matter," and he said, "Fine; go ahead"?

Mr. MILLER. Well, I said more than just that we had the expertise.

Senator SPECTER. That is what I would be interested to know. There is considerable interest where the line is drawn and what the policy is, as carried out by the Department of Justice and the Federal Trade Commission. That is why the committee is interested to know what standards you applied in this case, as being indicative of the general standards for division of responsibility.

Mr. MILLER. One of the factors that was involved was the fact that we had just concluded the *Exxon* case, and had a number of people with expertise who at that point were not vigorously pursuing other matters in the petroleum area.

Another factor was an indication that by historic standards this kind of case would have gone to the FTC.

Another factor was an indication from Mr. Baxter to then-Acting FTC Chairman David Clanton, made at the time of the Justice Department's taking the Conoco-Mobil merger, of an expectation that the next petroleum merger case would be taken by the Federal Trade Commission. That, and perhaps some other points that I cannot now recall, were the factors I raised in a very amicable discussion with Mr. Baxter about the matter.

Dr. Campbell may have additional recollections from his conversations with Mr. Baxter.

Senator SPECTER. Dr. Campbell, you had a separate conversation, different from the one that Dr. Miller has described?

Mr. CAMPBELL. I did, Senator.

Senator SPECTER. I think it would be worthwhile to inquire as to your conversation with Mr. Baxter on the subject.

Mr. CAMPBELL. It was rather brief. It took place late on that Friday afternoon, and I discussed with him our interest in the case. I mentioned to him that we had the expertise from the *Exxon* investigation and that our Petroleum Office was quite able to proceed.

He said to me, "Well, of course the best argument, or the only argument, on the other side"—as best I can remember his quotation, Senator—"is that we have just been through the *Mobil-Conoco* case," to which I responded that I was not at the FTC at that time. Indeed, I was working for the Department of Justice at that time, and I knew about that matter. I told Mr. Baxter that I really thought that, knowing about the Mobil-Conoco matter, we had the relevant expertise. Bill Baxter laughed, and he said, "Well, let me get back to you on that. I don't want to make the decision right away." About half an hour later, he had an aide telephone me to say that it was all right for FTC to go ahead.

Senator SPECTER. So it, in effect, turned on the Campbell agency. [Laughter.]

OK. Fine.

Would you proceed with your chronology, Chairman Miller?

Mr. MILLER. Yes, I would be glad to.

The Bureau of Competition under Dr. Campbell's leadership immediately began an intensive program of reviewing this potential merger for possible anticompetitive consequences, and worked through two weekends on the project.

I had longstanding engagements to go to west coast, among other things, and to visit the three FTC regional offices on the west coast. Before I left on Sunday, I talked to Dr. Campbell who indicated that the work was proceeding well and that the time period for a second request for additional information would expire at the end of the week. I was returning on Thursday evening.

I talked to my executive assistant, who informed me that matters were proceeding, but that, unfortunately, there had been some misinformation about what the Federal Trade Commission was doing. She and I agreed that it would be best for me to address this when I returned on Friday morning.

On Friday morning I had an extensive meeting with my senior staff to discuss the matter. There was a second request letter prepared for my signature when I came in on Monday morning. After extensive discussion, I signed the second request letter. That is what has happened thus far.

I did spend some time that Monday afternoon making some telephone calls to Senators and Congressmen, informing them of the status of the case. Dr. Campbell made at that time several presentations to staff of the Senate and the House as to the status of the Mobil-Marathon bid.

As you know, the news this morning is that United States Steel has tendered an offer to acquire Marathon. The white knight that Senator Metzenbaum referred to has come along, and we have not yet had an opportunity to assess that.

Senator, if I could I would like to make several points, I hope diplomatically given that my colleagues are sitting here. As I have said on many occasions, the Federal Trade Commission, in my judgment, needs to be run from the top down rather than from the bottom up. I hope to carry out that policy while I am at the Federal Trade Commission.

In that vein, I have asked the staff of the Federal Trade Commission to give us a range of options for the Commission to consider. One such possibility was a proposal that Mobil brought to the staff's attention. Of course, I am referring to the proposed hold separate agreement. Dutifully, Dr. Campbell negotiated with Mobil about that and subsequently showed it to Marathon.

There was a charge that it was a sweetheart deal. That was inaccurate, because we had every intention of sharing it with Marathon. Dr. Campbell shared it with Marathon's attorneys.

Senator SPECTER. What specifically are you talking about now?

Mr. MILLER. There was a hold separate agreement that was under negotiation between the Bureau of Competition and Mobil. It was not a sweetheart deal. In fact, we shared it with Marathon.

The second charge was that we were trying to cut Marathon out of the action. That was not true, because we had affirmatively shown it to Marathon's attorneys and asked them for their comments.

Another allegation was that it was going to be signed and have the effect of law. That is not the case because, under the Commission's own rules, a proposal like that could not take effect unless and until it was confirmed by the Commission itself.

Another thing, of course, was the argument circulating that the hold separate agreement was going to take the place of a second

request. That was untrue, because when I talked to Dr. Campbell the Sunday evening before I left for the west coast I expected to have a second request letter on my desk upon my return.

Senator SPECTER. What was the origin, if you know, of the thought that there was a sweetheart deal involved?

Mr. MILLER. I would not know.

Senator SPECTER. When did that first come to your attention?

Mr. MILLER. That, I think, was in the newspapers on Thursday.

Senator SPECTER. When you say that the Commission should be run from the top down, with the staff providing options, are you suggesting that there is some effort by some to run the Commission in some manner other than from the top down?

Mr. MILLER. If I had to characterize it, sir, it really is very much, I am afraid, reflective of the fact that the commissioners are in an investigatory mode at times and in an adjudicatory mode at other times, and there are ex parte communication restraints involved. In my judgment, over the past several years there has been too much of a tendency for the Commission's portfolio of activities to be determined by the staff and for these to percolate up to the commissioners for their consideration, rather than the commissioners giving guidance to the staff as to how to reorder their priorities.

Senator SPECTER. Are you actively seeking to change that situation?

Mr. MILLER. Yes.

Senator SPECTER. Without intruding into any prohibited area, I would like to come to a key statistical consideration which I find very troubling with respect to the central question of substantial lessening of competition. For illustrative purposes, I refer to statistics provided to me showing the share of the market in Robinson, Ill., where Marathon, according to the information I have, has 64 percent of the market and Mobil has 23 percent of the market, for an obvious total of some 87 percent.

I do not think that this question comes anywhere near the situation of Pillsbury in the mid-1950's, but in an area which is very complex, where there are so very many questions, and where we are about to interrupt to go and vote, I would like your observations on the potential anticompetitive effect horizontally in a situation as, for example, in Robinson, Ill., if Marathon and Mobil were to merge.

Mr. MILLER. Senator, I have been advised by my general counsel, Mr. Jack Carley, that I do stand in substantial danger of being disqualified or having a suit brought to have me disqualified, should I address any particulars about the Marathon-Mobil matter. I think, however, that such a question might be addressed properly by Dr. Campbell if you would like him to respond.

Senator SPECTER. The same question, Dr. Campbell.

Mr. CAMPBELL. Thank you, Senator.

I believe the statistic to which you refer is taken from the terminal market, and that it is not 64 percent of retail gasoline but, rather, that 64 percent of the terminal space at Robinson, Ill., is used by Marathon.

Senator SPECTER. The category I have it under is competing terminals for sales of motor gasoline and distillates.

Mr. CAMPBELL. That is precisely my understanding.

The issue there is on how the terminal aspect of the vertical provision of gasoline from the oil well to the gasoline pump figures competitively.

We knew the statistic; it was a matter pled in Marathon's complaint, and I knew about it earlier from Marathon. What is relevant is to ascertain what other sources of supply there are to what relevant geographic market other than through these terminals. The terminal concentration in any given city, village, or town would not, in and of itself, constitute sufficient cause to believe there is an anticompetitive impact in a relevant line of commerce.

In analyzing that precise statistic—and I have focused on that precise one, and on the other individual instances given by Marathon—I focused on what other ways there are of supplying gasoline.

Senator SPECTER. What are the other ways to accomplish that specific function in the Illinois area?

Mr. CAMPBELL. I am not sure what the appropriate relevant geographic market is—if it is Chicago, for example, one might say the terminal located in Robinson can furnish it; a terminal located in Geneva could furnish it; a terminal located in Gary, Ind., could.

The consumption of gasoline in Robinson, Ill.—if that is the specific area of your inquiry—is not addressed by the fact that 64 percent of the terminals in Robinson are owned by Marathon. Rather, it would be addressed by how many of the gasoline pumps are owned by Marathon.

Senator SPECTER. What function is performed by these competing terminals?

Mr. CAMPBELL. Supplying a standard metropolitan statistical area. After gasoline has been refined and is sent through a pipeline, it would then be stored in a terminal for eventual delivery to distributors and then to retailers in some market that we consider geographically relevant.

Senator SPECTER. You are saying the first line would be to distributors?

Mr. CAMPBELL. Yes.

Senator SPECTER. If you have one company, Marathon, with 64 percent and the other company, Mobil, with 23 percent, and there is a combination through merger of those two, would that not substantially lessen horizontal competition for that function performed by the competing terminals?

Mr. CAMPBELL. It depends, Senator, on the geography. If you could specify the area, I could answer it more precisely. Again, to go back to my example, if Robinson is supplying Chicago, there are a large number of other terminal sources which are able to supply Chicago.

Senator SPECTER. Assume that Robinson is supplying Robinson only. We know at least that Robinson is doing that. Is that right?

Mr. CAMPBELL. I do not believe we do, Senator. It is a different issue to know who owns the gasoline pumps in Robinson, Ill., than knowing who owns the terminals.

Senator SPECTER. Have you conducted an investigation then? If you are now saying that it is not certain on its face that Robinson, Ill., is at least supplying Robinson, Ill.? Have you conducted an investigation to disprove that?

Mr. CAMPBELL. Yes.

Senator SPECTER. What have you found?

Mr. CAMPBELL. We have not reached a conclusion. We are analyzing what is called PADD II with a great degree of particularity.

Senator SPECTER. If you were to find, hypothetically, since you do not have a factual conclusion at the moment, that Robinson, Ill., was at least supplying Robinson, Ill., would that not be a pretty conclusive indication of a substantial lessening of competition?

Mr. CAMPBELL. The next question on the hypothetical that you have put would be whether that one city is a relevant geographical market for Clayton Act, section 7, purposes.

Senator SPECTER. I have not come to that question; I have only come to the question as to Robinson, Ill. And you may say that it would not constitute an antitrust violation because of the relevant market which you bring up. But limiting it first just to Robinson, Ill., would that not be a substantial lessening of competition their?

Mr. CAMPBELL. If I could state the assumptions, if a relevant geographic market is defined to be Robinson, Ill., and nothing else, and if we have a relevant product market—let us call it gasoline retail; and if Marathon has 64 percent of gasoline retail and Mobil has 23, then I would be disposed to believe that would constitute a violation of the Clayton Act.

Senator SPECTER. That is a good place to recess for just a few moments. We will go and vote and be right back.

[Recess taken.]

Senator SPECTER. We will reconvene. I regret the delay.

You may be interested to know what happened procedurally. When we left, there was an issue raised by Senator Danforth on foreign trade assistance, which was defeated 49–46. There was a motion to reconsider and a motion to table that. It tied 47–47, which then required a lot of procedural shifting. Then the majority leader, Senator Baker, interrupted with a resolution commending the President for his foreign policy speech yesterday on missiles. Therefore, in the intervening time there were three votes, and not one, that occasioned the delay, which delay I regret.

To repeat, we will resume, and as soon as Senator Metzenbaum returns—which should be imminently—I will cede the floor to him for his turn of questions. Until he returns, I will proceed with some other questions.

CABINET COUNCIL

Dr. Miller, are you familiar with the functioning of the Cabinet Council as it relates to antitrust matters?

Mr. MILLER. Yes. There are several Cabinet councils. I believe the council one name is similar to Commerce and Trade, is the council that considers antitrust issues.

Senator SPECTER. Who is on the Cabinet Council on Commerce and Trade?

Mr. MILLER. I do not remember the entire membership, but I recall that it includes, Secretary Regan; Secretary Baldrige; probably Secretary Donovan; Murray Weidenbaum; Dr. Marty Anderson, President Reagan's domestic policy advisor; and probably others. OMB Director David Stockman is probably on it as well.

Senator SPECTER. Does anyone from the Department of Justice participate?

Mr. MILLER. The Attorney General is probably a member.

Senator SPECTER. Is anybody from the Federal Trade Commission involved in any way with the Cabinet Council?

Mr. MILLER. No not as a member of the Council itself. The Council has several working groups, to which I understand we have contributed a staff member.

Senator SPECTER. When you say working groups, Dr. Miller, what do you mean by that?

Mr. MILLER. These are groups to investigate a particular issue and to do research and report to the Cabinet Council.

Senator SPECTER. And you have contributed a staff member?

Mr. MILLER. I understand that we have. I also have had some discussions about perhaps doing more of this.

Senator, the Federal Trade Commission is given a mandate by law to provide expertise to the Congress and to others on economic matters, and I see no reason why we should not make that expertise known to anyone who asks for it.

Senator SPECTER. Where do you find that mandate specifically, Dr. Miller?

Mr. MILLER. The Federal Trade Commission Act indicates—I do not have a copy of the act before me—that one of the functions of the Commission is to conduct studies and make known the results of its studies.

Senator SPECTER. My question goes to your statement about a mandate to assist the Congress and others. The Congress, I can see; but others, to include the Executive branch?

Mr. MILLER. Perhaps I was inarticulate on this point. What I meant is that the Commission is given a mandate to have in-house expertise on economic matters and to share this expertise. I shall be happy to stand corrected if that is incorrect.

Senator SPECTER. Dr. Campbell, are you familiar with the specific provision that Dr. Miller is referring to?

Mr. CAMPBELL. I am familiar with it, Senator. I cannot quote it for you. I would be happy to check right now or refer back to answer your question.

Senator SPECTER. We will take a look for it, but I would appreciate it if you gentlemen would, as well.

When you say that the FTC contributes a staff member, could you amplify what that staff member does and with whom he works, Dr. Miller?

Mr. MILLER. Senator, I would be more than happy to provide you that for the record.[1]

As I recollect, I asked someone on my staff if the Commission had had any relationship with the Cabinet Council and said I thought it was a good idea for us to provide staff support in case there were particular issues that arose on which we had expertise. For example, that would include cases involving particular industries, say, where the Justice Department would not have the particular expertise but where the Federal Trade Commission would,

[1] See page 95.

pursuant to the interagency liaison agreement we have. And I felt we should share that expertise.

Dr. Campbell has located the specific portion of the Federal Trade Commission Act.

Senator SPECTER. You have? Fine.

Mr. CAMPBELL. There may be others, Senator, but on quick reference, section 6(c) of the Federal Trade Commission Act——

Senator SPECTER. Do you have a citation on that? Title 15, United States Code, what?

Mr. CAMPBELL. It is title 15, United States Code, section 46.

Senator SPECTER. I have got that.

Mr. CAMPBELL. That is subsection (d).

Senator SPECTER. "Upon the direction of the President or either House of Congress to investigate and report the facts relating to any alleged violation of the antitrust acts by any corporation"?

Mr. CAMPBELL. Exactly. Then continue with (e) and with (f): "(e) upon the application of the Attorney General to investigate and make recommendations for the readjustment of the business of any corporation alleged to be violating the antitrust acts," and I omit the rest; and "(f) to make public from time to time such portions of the information obtained by it hereunder as are in the public interest," and I again omit the rest.

Senator SPECTER. What in that language do you see as a mandate to share expertise with the executive branch of the Government?

Mr. CAMPBELL. That "the Commission shall have the power to make public from time to time such portions of the information as are in the public interest;" that the Commission shall have the power "Upon the direction of the President . . . to investigate and report the facts relating to any alleged violation of the antitrust acts;" and that the Commission shall have the power, "Upon the application of the Attorney General to investigate and make recommendations" regarding violations of the antitrust law.

Mr. MILLER. Senator Specter, I apologize. Not being a lawyer, perhaps I used the word mandate in a rather imprecise way, but I think the law speaks for itself. That is what I had in mind.

Senator SPECTER. The sections which Dr. Campbell has just read do not, to me, comprehend a mandate or an authorization to share expertise with the executive branch of the Government.

The language with respect to making information public is just that—public—as opposed to sharing it with the executive branch of the Government, and the language with respect to reporting facts after investigation relating to alleged violations of the antitrust acts is really not a sharing of expertise.

The concern that I have, Dr. Miller, turns on the issue of independence and separation of powers of the Commission from the executive branch of the Government. I have a concern, which I expressed to Assistant Attorney General Baxter, about the participation of the Cabinet Council in what appears to me to be a violation of title 28 of the United States Code, which provides:

> Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party or is interested, securing the evidence therefor is reserved to officers of the Department of Justice under the direction of the Attorney General.

This is a digression from what I have been asking you about, and I am going to come back to that, but this is in line with the questions which were put to Mr. Baxter when he was here a couple of weeks ago.

The concern which I have and which was inquired into on the *A.T. & T.* case turns on whether it was appropriate to have anybody other than the Department of Justice have any participation or make any recommendation at all on the termination of that case or request for the 11-month delay.

Before getting to questions about the FTC, I would be interested in your judgment on that question and, perhaps preliminary to that, your knowledge of any of the facts. Did you participate in any discussions of the *A.T. & T.* litigation with Mr. Baxter or anybody from the Justice Department?

Mr. MILLER. No, sir, I did not.

I would only comment that, first, the Cabinet Council looks at a very broad variety of issues, not just antitrust issues, if that be the case. The second point is that, not being privy to those kinds of issues, I would not want to venture any statement about them.

Senator SPECTER. So you really have no knowledge as to what the Cabinet Council did or did not do with respect to the *A.T. & T.* case?

Mr. MILLER. That is correct. I have no knowledge. I have read things in the newspaper, but I have no personal knowledge.

Senator SPECTER. Would you care to comment on your view of the propriety of the Cabinet Council making a recommendation on dropping the A. T. & T. case?

Mr. MILLER. I would not want to comment on that.

Senator SPECTER. Dr. Campbell, you are a lawyer as well as a Ph. D., as I understand it. Would you care to comment on that question?

Mr. CAMPBELL. I do not think it is appropriate for me to have a comment on that, Senator.

Senator SPECTER. I shall not press it, if you choose not to comment.

Going back now to the issue of the FTC, you were quoted, Dr. Miller, in the Wall Street Journal on October 27 to this effect:

> Mr. Miller, who came to the FTC from the Office of Management and Budget, said he plans to remain in contact with his friends in the Administration and discuss policy issues with them. That assertion is likely to raise hackles on Capitol Hill. By law, independent regulatory agencies are accountable to Congress rather than to the White House.

Were you accurately quoted, Dr. Miller?

Mr. MILLER. As I recollect, reasonably accurately quoted. That does reflect my views.

Could I indicate to you, sir, that perhaps there might be some misconception on the matter of the Cabinet Council? To my knowledge, any work that the Federal Trade Commission staff has done with the Cabinet Council has not involved any matters in adjudication before the Federal Trade Commission. I think it would be inappropriate for them to do so. The FTC staff was studying particular industries and doing that type of work to the best of my knowledge. I would be glad to supply you with more definitive information if you so desire.

Senator SPECTER. I would. Specifically, I would like to know what subject any member from the staff of the Federal Trade Commission discussed with anybody from the Cabinet Council or anybody from the executive branch.

When you talk about matters in litigation, Dr. Miller, it may be troubling, or at least I find it troubling, how you draw the line between what is in litigation and what may get into litigation.

In the antitrust field, we are dealing with a very complex set of variable factors where a litigation decision turns on a policy judgment which has no clear lines of demarcation. There are hardly any dotted lines to say when it crosses into a violation of the antitrust laws and when it does not.

If the executive branch, the Cabinet Council, and those in the executive branch participate in the making of policy, they may well be making judgments which stop something from getting into litigation. Is that not so?

Mr. MILLER. Well, sir, could you tell me how? I do not see how it could be the case. As I have just indicated, I do not think it would be appropriate for Federal Trade Commission staff to participate in Cabinet Council work involving matters that are in litigation before the Federal Trade Commission.

In terms of things that might possibly get into litigation, it is hard to draw, I suppose, a hard and fast rule. We do have rules about ex parte communications at the Federal Trade Commission, for example, but matters that might possibly result in litigation in the future I can discuss with my staff at any time. When it becomes a matter in adjudication, then all ex parte comments must cease, unless the communications are on the record.

Senator SPECTER. You are talking about your staff now, and I can see that situation where you have a function which is all investigatory, prosecutorial, and adjudicatory.

Mr. MILLER. Staff does not have the adjudicatory role.

Senator SPECTER. I am talking about you. You have that as the Commissioner and certainly as the chairman, but the freedom that you would have in talking with your staff, because they do investigative work for you and prosecutorial work for you, would not necessarily apply to conversations with people in the executive branch.

As I understand your role—and I had reviewed the case of *Humphreys Executor* v. *United States,* which defines the role of the Federal Trade Commission——

Mr. MILLER. I am familiar with that decision.

Senator SPECTER. I was sure you would be. It does so in terms of "a board or commission of dignity, permanence, ability, independent of executive authority except in its selection, and independent in character." That is language which is quoted from Senator Newland, who reported out on the bill. It was adopted by the Supreme Court of the United States as the controlling characteristics of the Federal Trade Commission.

My question is this: Do you retain that independence from the executive if you remain in contact or discuss with the executive policy matters regarding what the enforcement of the antitrust laws ought to be?

Mr. MILLER. I believe so, yes.

Sir, we will be happy to provide you with our own appraisal of the appropriate role of the Commission staff in dealing with White House Cabinet councils, if that would be of benefit.

Senator SPECTER. I have already covered that, and I think it would be of benefit. But let us explore your last answer, where you say, as I understand you, that you think it appropriate. Let me ask this question: Do you think it appropriate for you, as Chairman of the Federal Trade Commission, to confer with members of the executive branch in arriving at the standards you consider constitute antitrust policy or what would be a violation of the antitrust laws?

Mr. MILLER. Yes, sir, just in the same way that I would discuss those matters with Members of Congress, with the chairmen of the Commission's authorizing committees in both Houses, the chairmen of our agency's appropriations committees in both Houses, with former academic colleagues such as Yale Brozen seated behind me, and any other person who might have some views on this matter.

The question would raise significant qualms in my own mind if it was a matter in adjudication before the Commission. I have a very firm rule that I would not engage in any discussion on any adjudicative matter.

Senator SPECTER. If you have a given set of facts, that could lead to litigation if you conclude that it violates antitrust laws, there is a substantial amount of discretion, is there not, in a decision whether a given set of facts constitutes a violation of the antitrust laws? You are nodding yes; you agree with that?

Mr. MILLER. Yes, sir.

Senator SPECTER. If you discuss that with, say, the President, hypothetically, and he says to you, "That is not a violation of the antitrust laws," and you accept that judgment, have you not given up the independence which the law says you were to have?

Mr. MILLER. Senator, that is a hypothetical that I view very unlikely, and I, frankly, would not want to comment on it. Second, even if I were to comment, I would not have a firm view on it. To me, it is so unlikely that I have not even thought about it.

Senator SPECTER. Assume that you had a conversation with Secretary Baldrige, where he said to you, when you were talking about a given case, "Look, here, this is the kind of activity which is necessary for commercial development, and it ought not to be considered a violation of the antitrust laws."

Mr. MILLER. Again, sir, that is a very hypothetical question. I have not faced any situation resembling it. I doubt very seriously that Secretary Baldrige would address me in such a way, and if he did, I would say, "Mack, wait; that is in adjudication; I can't talk about that." I am sure that at that point he would observe that admonition.

Senator SPECTER. So you think if it went to that extent it would be an intrusion on the independence of the FTC?

Mr. MILLER. I would just walk away from it. I would not be compromised. I do not believe I would be compromised. It is a very hypothetical case.

Senator SPECTER. The point is that you think that would be a compromise—it would be an intrusion on your independence.

Mr. MILLER. Sir, I am saying that I would not be compromised. I would simply walk away from such a conversation if it were a matter in adjudication.

Senator SPECTER. What do you consider then, Dr. Miller, to be the permissible ambit of executive input into policymaking decisions by the Commission?

Mr. MILLER. Let me relate to you the types of discussions with my friends in the White House that I think are perfectly appropriate. One would be discussing matters involving the budget—what the President may recommend to the Congress for the FTC's budget. I think it wholly appropriate for me to talk with David Stockman, Ed Harper, Annelise Anderson, or Glenn Schleede, our own budget examiner, Dale Poster-Ellis, or anyone like that on such a matter, or to discuss matters relating to the work I did before I came to the Federal Trade Commission, including broad issues involving regulatory relief. I continue to have an interest in that area.

There have been occasions when I have discussed matters with my successors, and with other friends of mine who are actively pursuing the regulatory relief program, giving advice. I have visited people at the White House for purely social reasons, and none of these instances, I believe, violated in any way any of my independence as Chairman of the Federal Trade Commission.

Senator SPECTER. I do not disagree with any of the enumeration you have just made, but that excludes any consideration of what antitrust policy should be. Do you exclude a discussion of antitrust policy with your contacts at the White House?

Mr. MILLER. That has not arisen so far, except that at the White House I have chatted with Mr. Baxter, in the most general terms, about antitrust policy.

Senator SPECTER. Putting Mr. Baxter aside for just a minute, do you think it would be inappropriate for you to discuss antitrust policy with your friends at the White House?

Mr. MILLER. I do not believe so. Provided it were couched in terms of very broad principles, I would not have any concerns about it, any more than I would have concerns discussing antitrust policy with a Member of Congress, with an academic colleague, or with anyone else.

Senator SPECTER. But there is no question but what, in a discussion with an academic colleague, there would not be any effort to dominate your views or any reason for you to be dominated by those views. Perhaps the answer would be the same—that if you were talking to the President, there would be no reason to be dominated by his views on antitrust policy if you should have those discussions. Is that your point?

Mr. MILLER. Sir, there are gradations, of course, in the degree to which I would be influenced, perhaps. I am much more likely to be influenced by a Member of Congress than one of my academic colleagues.

But, sir, I try my very best to reach decisions based upon my best evaluation of the evidence. That is what I promised you, and that is what I promised the White House, when I accepted the job as chairman of the FTC. If matters came to a point where I felt that

my independence in making those judgments would be violated, I would raise a flag.

Senator SPECTER. So the ultimate issue then, as you define it, is your own independence in making the judgments?

Mr. MILLER. Yes.

Senator SPECTER. But you have no hesitancy in having discussions with members of the executive branch on those questions of antitrust policy, reserving to your own judgment the final determination as you see your own independence?

Mr. MILLER. That is right. In other words, I would apply the same rule in discussing such issues with Congress. But I am also mindful that there are cases where FTC Commissioners have been disqualified by virtue of being under duress by Congress. I would not want to be under that same duress by the executive branch in a similar situation.

Senator SPECTER. It is a somewhat different focus that I come to, and that is, not with respect to a specific case, but with respect to the formulation of antitrust policy. You have that responsibility as Chairman of the FTC, and it is my concern that you exercise it as you see your judgment, as opposed to what anybody else in the executive branch may see as what the antitrust policy should be.

Mr. MILLER. Sir, I promise you that independence. In a very hypothetical case, if the President called me up and asked me to do something that was against my judgment—and this is very hypothetical—I would have to make a big decision.

Senator SPECTER. Why would that be a big decision? You are independent of the President.

Mr. MILLER. Well, at such a point I would have to discuss with my counsel what authority the President had in that regard, but I assure you this: I would not make a decision that violated my independence. The questions you raise, sir, are very hypothetical.

If I could give you just a brief perspective: I think it is remarkable that everyone at the White House has been very reluctant to say anything about antitrust policy to me in my official capacity as Chairman of the Federal Trade Commission.

Senator SPECTER. I think that is fine. The questions really arise in the context of the *A.T. & T.* litigation and the approach in enforcement from a new administration. The case of *Humphreys Executive* v. *United States* flatly says that the Commission was not to be subject to anybody in the Government but only to the people of the United States, free from political domination, control, or the probability or possibility of such a thing to be separate and apart from any existing department of Government not subject to the orders of the President. That is pretty direct and unequivocal.

Mr. MILLER. Sir, I understand that. In case something like that happened, I would have to respond at that time. The possibilities you have raised with me are very hypothetical. It is difficult for me to respond. I am sorry that I cannot give you more definitive answers. I can tell you what has happened—the kind of discussions I have had so far—but it is hard for me to respond in any other way.

Being an academic, I have a rather firm view that one ought to do the right thing. I promised the Congress and the Executive that I would make decisions to the best of my ability on the basis of what the evidence showed.

Senator SPECTER. Senator Metzenbaum joined us just a moment or two ago.

Senator?

MOBIL'S PROPOSED ACQUISITION OF MARATHON

Senator METZENBAUM. I thank you very much, Senator Specter.

I am not sure, when I was leaving, whether or not I heard Senator Specter inquire of you as to the status of the Marathon-Mobil merger at this point.

Mr. MILLER. Yes, sir, I summarized that.

Senator METZENBAUM. Just give me a one-liner.

Mr. MILLER. The one-liner is that we have investigated the situation to the best of our ability. I am convinced it has been a first-class job. The news this morning of the tender offer by United States Steel is something we will also look into.

I have signed a second request letter, sir, as you probably know. That information will be coming in shortly. Even had the tender offer not been made by United States Steel, I still would not be in a position to tell you very much about the case in terms of the merits of the case.

Senator METZENBAUM. Is my understanding of your answer correct—that the FTC will look into the United States Steel-Marathon merger as well?

Mr. MILLER. Yes. I have every intention of doing so.

Senator METZENBAUM. And the jurisdiction will be with the FTC on that?

Mr. MILLER. We have not had an opportunity, Senator, to talk with the Justice Department about that particular issue, but I would be surprised if Mr. Baxter had any problems with our investigating that case as well.

Senator METZENBAUM. Without in any way attempting to ask your conclusions, because obviously you cannot reach any conclusions the very day you learn about the facts, can you give me any estimate of the timetable with respect to the United States Steel matter?

Mr. MILLER. Let me ask Dr. Campbell to answer that.

Mr. CAMPBELL. Senator, with your permission——

Senator METZENBAUM. Surely.

Mr. CAMPBELL. My best estimate is that if United States Steel has filed its Hart-Scott-Rodino material with us today and we begin to analyze them, we have under Hart-Scott-Rodino, if it is a cash offer, 15 days in which to make a decision as to whether we should request more information. At this stage, I am so unfamiliar with the details of United States Steel's proposal that I do not even know whether it would fall under the 15-day waiting period for cash offer or the 30-day period for other offers. But let us assume it is the 15-day period.

If the Commission decides by the end of that period that staff would benefit from more information before making a recommendation to the Commission, then the Commission would issue a second request to United States Steel. They would have as much time as it took for them to prepare their response, and we would

have 10 days following that before we had to recommend a course of action to the Commission.

Senator METZENBAUM. Has Mobil begun to comply with the second request as far as furnishing you with the necessary information is concerned?

Mr. CAMPBELL. I am in a bit of a difficulty, Senator. Let me explain it to you very candidly. As I read the Hart-Scott-Rodino Act, I am prohibited from disclosing or making public any information supplied to the Commission under the Hart-Scott-Rodino Act.

Senator METZENBAUM. I am not really asking for information. The question I am asking is: Have they started to supply you with some of the information? I think that you may answer.

Mr. CAMPBELL. To be completely honest, Senator, our counsel tells me that is in doubt whether I could even say if they have begun to respond.

There is, of course, a way in which I would be completely able to respond, and that is if this committee, or any other duly authorized committee or subcommittee of Congress, were to request me; then of course I would respond.

Perhaps I could give you an indication of an answer without violating the Hart-Scott-Rodino Act and say that, in general, it is in the interest of companies in a position such as Mobil to submit as much of a response as quickly as possible, and the second request was issued to Mobil on November 13. I think that gives you the answer you need, Senator, without raising any question in my mind about my compliance with the law.

Senator METZENBAUM. I think you both would recognize that your timing and your involvement could, in and of itself, be determinative as to which company, if either, would be in a position to take over. That is certainly not the intent of the law, nor would I think it would accord with the inclination of the FTC.

It seems to me that I have a recollection of reading somewhere that the timing element between the Mobil and the Conoco deals did have an impact—that while Mobil was under some restraint, Conoco was not, and they were able to go forward. That kind of matter does concern me. Would you care to comment on that?

Mr. CAMPBELL. Surely, Senator. That hypothetical could apply if one suitor were to be given what is called early termination of the Hart-Scott-Rodino period and another suitor were not. I share your concern; that would trouble me. I do not believe the waiting periods should affect the outcome.

MERGER ENFORCEMENT POLICY

Senator METZENBAUM. Mr. Miller, I want to come back to some questions, and I think you wanted to respond. Maybe in some of my questions you will be able to do so, because I think I will touch upon some of those areas. If not, I would say, Mr. Chairman, that I certainly think Mr. Miller ought to be accorded an opportunity before we conclude to cover any points that I may have talked about in my opening comments that I do not inquire about at the moment.

Mr. MILLER. Thank you, Senator.

Senator METZENBAUM. You seem to think that possible efficiencies can justify a merger, as your remarks on pages 5 and 9 of your statement show. But the Supreme Court is really the final word on this subject. They have made it clear that efficiencies cannot justify a merger.

In the *Clorox* case, the Court said,

> Possible economies cannot be used as a defense of illegality. Congress was aware that some mergers which lessen competition may also result in economies, but it struck the balance in favor of protecting competition.

In view of that and the fact that the merger guidelines reflect those cases, how can you justify ignoring such clear Supreme Court language?

Mr. MILLER. Could I first have a reference to the statement, Senator?

Senator METZENBAUM. Yes. It is 386 U.S. 568.

Mr. MILLER. I am sorry, sir—in my testimony.

Senator METZENBAUM. Oh, I am sorry. Page 9——

> Another caution about challenging vertical mergers is that they are commonly based on efficiency considerations. These efficiencies may stem from a desire to diminish risks or marketing costs, or they may be the result of strictly technological considerations. As a consequence, broader challenges to vertical mergers are not likely to generate many benefits in terms of preserving competition, and, therefore, on balance, such challenges are likely to raise costs to consumers.

Then on page 5,

> Furthermore, it has been argued that the Government's approach to merger cases has failed to give appropriate weight to factors other than market shares and concentration that are important for sensible decisions. These include: (a) realistic consideration of the time within which entry or expansion of output can occur should a particular merger result in higher prices or other anticompetitive effects, (b) the efficiencies likely to result from a merger, (c) the constraints imposed by foreign producers.

Mr. MILLER. Yes, sir. What you just read was a statement of the things that one should consider not only in guidelines but, I believe, in determining whether a merger would be likely to substantially lessen competition or tend to create a monopoly under section 7 of the Clayton Act, or tend to constitute a monopoly under the Sherman Act.

The first quote you read to me was, again, in the context of how the Commission allocates its resources in addressing mergers. It did not say, in my reading, Senator, that this meant that we would not necessarily be able to find a merger lawful or we would be necessarily opposed to finding a merger unlawful, if it generated efficiencies.

I would note in this regard, sir, that while we have direct authority under section 7 of the Clayton Act, under the Sherman Act we essentially address the issue through section 5 of the Federal Trade Commission Act.

Under the Federal Trade Commission Act, section 5, the Commission essentially has a two-part test, to my understanding. First is the question of illegality under what are essentially Sherman Act standards, and second, whether redressing the issue would be in the public interest.

FTC BUDGET

Senator METZENBAUM. Let me come back to this matter of allocations of resources, because we are dealing with factors which have tremendous impact on the economy. I am not sure what your position is, but it would seem to me that if you are talking about *x* or *y* dollars in order to run the FTC, in order to have enough people to do the job that you are legally obligated to do, you ought to be saying to this Committee, which is the authorizing committee—I guess we are not the authorizing committee; the Commerce Committee is—"How big a budget cut are you suffering?"

Mr. MILLER. Sir, the current status of our budget is that the House has passed a $71.9 million budget for fiscal year 1982. The Senate last week adopted a $68.3 million budget, as I recollect.

Senator METZENBAUM. How does it compare to last year?

Mr. MILLER. What we had last year, as I recollect, was $75 million, and $68.3 million is at the current size of the Federal Trade Commission. In other words, if the Senate appropriations bill were to emerge from committee, the Federal Trade Commission would continue at the same level of effort that it has in the past. Of course, sir, as you know, I hope that we will improve our performance.

Senator METZENBAUM. You are saying that you do not have the resources, and yet the Congress is giving you anywhere from $17 million to $20 million more than you asked for, because it is my understanding that you supported cutting the FTC budget down to $51 million, and the Congress is giving you somewhere between $68 million and $71 million. Is that not correct?

Mr. MILLER. Sir, I have advocated the $61.8 million figure that the President had proposed to the Congress for fiscal year 1982 for the Federal Trade Commission. That figure was approved by two other Commissioners at the Federal Trade Commission, with Commissioner Pertschuk dissenting.

Beyond that, I simply cannot discuss figures with you, because those are communications with OMB pursuant to the Budget Finance Act passed by the Congress, and I cannot discuss that with you.

Senator METZENBAUM. I understand that.

Mr. MILLER. I will tell you, though, that I have not endorsed a figure of $50 million for the Federal Trade Commission.

Senator METZENBAUM. You did not support that in a public hearing?

Mr. MILLER. I did not.

Senator METZENBAUM. Do you think $51 million is too little?

Mr. MILLER. Sir, I really am not prepared to address the question of the appropriate size of the budget of the Federal Trade Commission at this time. We are engaged in a process of trying to reinvigorate the Federal Trade Commission and to improve its management, and I would not be able to tell you what I think the appropriate figure should be for the outyears.

Senator METZENBAUM. No, I am not talking about the outyears.

Mr. Miller, if you are saying you do not have adequate resources and it is a question of allocating your resources, and then you are saying, "But I don't know how much we should have"—and I just

asked you; you are the top man—who does know, if you do not know?

Mr. MILLER. Sir, I have testified and advocated a figure of $61.1 million for fiscal year 1982, and I think we could do the job with that figure. I have not advocated another figure.

Senator METZENBAUM. I have here an article that says:

> The cuts endorsed by the Republican-controlled FTC, if adopted by Congress, would ultimately reduce the Agency's fiscal 1984 budget from the Carter administration proposal of $81.7 million to $53.8 million, just above a figure of $51.1 million recommended by Reagan's Office of Management and Budget. With only FTC Member Michael Pertschuk dissenting, the Commission has accepted the cuts urged by new FTC Chairman James C. Miller, III, former regulatory tzar at OMB, who took the Agency's reins only a month ago.

That says that you did. You are saying that you did not. Is this article 100 percent wrong?

Mr. MILLER. Sir, not everything printed is correct. Let me simply repeat that, under the terms of the Budget and Finance Act, I am not at liberty to discuss any proposals made for the outyears. I hope I do not violate that by saying that the information that you just read from that article is incorrect.

Senator METZENBAUM. Is incorrect?

Mr. MILLER. Is incorrect.

Senator METZENBAUM. With that, I think we should go and vote.

Senator SPECTER. We will be right back.

[Recess taken.]

CHAIRMAN JAMES C. MILLER'S RESPONSE TO SENATOR METZENBAUM'S OPENING STATEMENT

Senator METZENBAUM [acting chairman]. Mr. Miller, because it seems that we are going back and forth on rollcalls and I myself have been called upon to bring up an amendment at the moment, I passed it so that I might come back. I want to be fair to you. I have some questions, but you had indicated that you wanted to respond to my opening statement. I think this might be a good time for you to do it, provided you are not too lengthy in your response.

Mr. MILLER. Yes, sir, I would be happy to do so.

Senator Metzenbaum, I am a bit troubled by the quote you attribute as being made by me at my confirmation hearing. Your quote reads:

> I really do not perceive it to be the role of the Federal Trade Commission to decide that that so-called concentration of wealth or power is excessive * * * so there are efficiencies that can be gained from conglomerate mergers. That is the focus—the economic efficiency.

Sir, from an official copy of the hearing, let me give you my complete answer to a question about conglomerate mergers. I said,

> Well, sir, let me say that with respect to the conglomerate merger issue, a very large conglomerate merger could mean a very large firm, even in nationwide market, but

and here is where your quote picks up, sir—

> I really do not perceive it to be the role of the Federal Trade Commission to decide that so-called concentration of wealth or power is excessive * * *.

And then, what is missing from the ellipsis in your quote that appears to be part of the same paragraph is as follows—continuing on in my statement—

I think that that is something for Congress to determine itself. Such a conglomerate may create efficiencies. There may be synergism among the different kinds of enterprise that, when brought together, means that you can achieve the production of different kinds of products and services at lower cost. Sometimes the temporal demands on the sales forces will be different. There are other seasonal issues. Sometimes access to capital is different among the various components—

then, sir, here is where your quote apparently picks up—

so there are efficiencies that could be gained from conglomerate mergers.

And the official transcript says "should" instead of "is." I said, "That should be the focus—the economic efficiency of the outcome." I think that differs, sir, from the general thrust of the shortened version that you have.

Senator METZENBAUM. Now you have to help me, because I am not clear as to how you are suggesting that the thrust of that which I quoted—and indeed I did quote the entire statement—is different than the thrust of what you said.

Mr. MILLER. Sir, I quoted the entire statement. Sir, you have in your press release a much shortened version of it that does not, I think, really communicate the particulars of what I had in mind.

Senator METZENBAUM. I do not want to ever quote you or anybody else out of proper context, but I said that you had stated that you do not perceive it to be the role of the Federal Trade Commission to decide that so-called concentration of wealth or power is excessive. "So there are efficiencies that can be gained from conglomerate mergers. That is the focus—the economic efficiency."

Now, you are saying to me that my emphasis on that portion of your statement is distinguishable from the emphasis of the statement you made. What I am asking you to do is to tell me the difference in the thrust or the import of what you said in contradistinction to the import of what I quoted you.

Mr. MILLER. The import is twofold, sir. One is that what is contained in the sentence that was quoted—the section quoted is not what I would write and is an incomplete representation.

The second point, sir, is that I indicated that my colloquy with Senator Kasten on that issue was on the question of whether aggregate economic power or wealth was something for the Federal Trade Commission to address as a generic issue. I said no, that in my opinion this was something for the Congress to address. That meaning is not included, sir, in the quote that you attribute to me. I also explained what I meant by the efficiencies.

Senator METZENBAUM. I do not think we have to belabor the point. I will accept your statement, but as I see it I also said that you said you did not perceive it to be the role of the Federal Trade Commission to decide that so-called concentration of wealth or power is excessive. The point I did not quote was the fact that you indicated that was the responsibility of the Congress.

Mr. MILLER. That is right.

Senator METZENBAUM. Fine. But I also used the statement to point out that you indicated that there were efficiencies that can be gained from conglomerate mergers. I had earlier read you a

statement from the Supreme Court that said that those are irrelevant, and I am not quite certain what your point is, other than the fact that I did not quote you in entirety. But that happens to me so often that I do not see why I should feel any more sympathy for you than for me, as long as they get the thrust of what I am saying.

Mr. MILLER. Again, sir, my reading of your quotation tends to attribute to me the argument that it is not the business of the Federal Trade Commission to address concentrations of wealth and power because efficiencies are gained. That was not what I was saying at my confirmation hearing; rather, I said that it is an issue for the Congress to address.

Senator METZENBAUM. I do not think that is what was said, but let us let the record speak for itself.

Mr. MILLER. All right.

Senator Metzenbaum, your next quotation you attribute to the FTC transition team report. As you probably know, on advice of White House counsel, I am not at liberty to confirm or deny that what you have quoted there, and what you put in the Congressional Record on September 21, 1981, page S 10163, is indeed the transition team report.

I apologize, because I have had to look at this very quickly, since I did not have the advantage of seeing your opening statement earlier. You quote me as saying, "The foreclosure argument erroneously assumes that the merger would not result in increased efficiencies."

Senator METZENBAUM. Is this the speech I made on the floor that you are responding to?

Mr. MILLER. No, sir. This is what you read this afternoon, addressed to me.

Senator METZENBAUM. OK.

Mr. MILLER. Next there is the ellipsis in your quote, and you say, "It would seem that agency efforts to restrain vertical mergers are, by and large, misdirected." However, the complete text of what I said, Senator, I think bespeaks more thoughtful consideration of the issue than is suggested there.

The 4 lines that are quoted in your statement and attributed to me are something on the order of 15 lines in the statement. I think it is something of a mischaracterization of what I said, but in the interest of time, sir, I will not discuss it further.

Senator SPECTER [acting chairman]. Dr. Miller, may I interrupt you for just a minute?

Mr. MILLER. Yes, sir.

Senator SPECTER. I think you are perfectly within your rights to respond, as Senator Metzenbaum has invited you to, to his opening statement. I would request that you be as brief as you can, because we have a witness from Chicago whom I want to call as soon as I can.

Mr. MILLER. Fine.

Senator SPECTER. This truncated hearing has been problemsome, for obvious reasons, but to the extent that you can abbreviate it, it will be appreciated.

Mr. MILLER. I will be happy to, Senator. Of course, at the earlier time I did come and spend a great deal of time waiting without ever being called to testify. But let me go on.

Senator SPECTER. You are exactly right about that.

Mr. MILLER. The third quote attributed to me on page 2 of Senator Metzenbaum's statement also contains a mistake, but let me point out in this regard that I think I have adequately made the point in my testimony today about allocation of resources. Also let me point out that this quote was in the context of what is alleged to be the report, where I was discussing matters generally. It was discussing the policies and programs of the Federal Trade Commission in general. It was not speaking directly to the antitrust issue.

Second, it was also addressed to the question of guidelines, about what the Commission's activities should be, and not to the legality or illegality of a particular action on the part of a firm with respect to a merger.

On the question of Robinson-Patman Act enforcement, I have promised that I will enforce the Robinson-Patman Act. I have serious concerns, though, about the way the Robinson-Patman Act has been enforced in the past.

I would just like to indicate that I have an excerpt here from one of the classics in the field, F. M. Scherer's "Industrial Market Structure and Economic Performance." By the way, Dr. Scherer is an expert witness for Marathon in its case against Mobil that is being heard in Cleveland by a Federal district court right now.

Dr. Scherer points out in his text—let me quote:

> There is a further irony in the FTC's enforcement record. As we have seen, the Robinson-Patman Act was passed to help small businesses. Nevertheless, of the 564 companies named in FTC Robinson-Patman complaints between 1961 and 1974, only 36, or 6.4 percent, had annual sales of $100 million or more at the time of the complaint. More than 60 percent had sales below $5 million. Thus, the brunt of the Commission's enforcement effort fell upon the small businesses Congress sought to protect.

So yes, sir, I am a critic of the Federal Trade Commission's enforcement of the Robinson-Patman Act.

Finally, on the question of the final quotation you attribute to me, sir, I have been unable to have delivered to me a copy of my transcript, but that does appear to be an accurate representation of what I said.

However, I did not at that point, to the best of my recollection, or at any other time, refer to shabby goods, or say that people should consume shabby goods, or that manufacturers should make shabby goods. That is a mischaracterization that has been put on what I have said by other people.

What I really meant, sir—if I could give you a rather homey example—is this. Take a hammer, for example. I worked as a carpenter's helper during college, and you know that you have to have a very fine 16-ounce hammer to really do that job properly, and the first thing I did was to buy one.

But there is a very wide range of prices and qualities of hammers. I also had a hammer in my office that I used for nothing more than putting up nails to hang up pictures. Since I tend to change jobs pretty often, it is good to have a hammer around.

This was a very inexpensive hammer, and it was not a reliable hammer. It was not a hammer that was made to take 50,000 strokes. It would do good to take 500 or maybe 1,000 strokes. Indeed, as if a test of that hypothesis, one of the workmen at the Federal Trade Commission borrowed it and broke the head off.

The point is, sir, that people should have opportunities to buy very inexpensive hammers that are not nearly so reliable as the Cadillac hammers, the Craftsmen hammers, or the Plumb hammers, or other top-of-the-line products. I think people ought to have opportunities to buy both top-of-the-line and bottom-of-the-line products. But I do not endorse manufacturers providing shoddy merchandise.

Thank you, sir.

Senator METZENBAUM. I guess I am not the only one who raised that question as to the interpretation of your statement. "Advertising Age" also in their editorial of November 9 said:

> Self-regulation is not self-contained. Its ultimate persuasiveness rests on the existence of a vigorous FTC ready to insist that all advertising be truthful and that advertisers substantiate their performance claims. When FTC retreats, it also exposes the self-regulation flank.

Mr. MILLER. Sir, I will be happy to provide this committee with a copy of the official transcript, so you can see what I actually said. Second, I would be glad to provide you with a copy of a speech I recently gave in San Francisco on the issue of ad substantiation. I think there, too, my views have not been adequately reported.

Senator METZENBAUM. We have that. Thank you.

Let me ask you this. You said to me you could not answer anything about the transition team report on advice of White House counsel. Would you explain that to me?

Mr. MILLER. Sir, my understanding is that the issue of transition team reports is one that might well be in litigation. People who were members of transition teams have been advised not only not to share copies of the reports—in fact, those reports were picked up from us—but also not to affirm or deny that anything that is purported to be a copy of the transition report is or is not a copy of a transition report.

As a generic issue, I very much agree with that position. I think that if Presidents knew that any transition report would be made public, then Presidents, Democrat or Republican, would only choose people to be members of transition teams who would give them the recommendations they expected.

Second, I think that anyone who agreed to serve on a transition team would not be as candid in giving advice to a President if they knew that this could not be information that would be read only by the President and his advisers.

Senator METZENBAUM. As you know, I inserted the transition team report into the Congressional Record.

Mr. MILLER. I read from what you inserted in the Congressional Record, sir. I would not comment beyond that.

Senator METZENBAUM. Mr. Chairman, I have a number of questions, and you have been very courteous to me at all times. I know you have indicated that there is a gentleman here from Chicago. I have a large number of questions that I would like to submit to Mr. Miller.

If the answers are not satisfactory, I would ask you to reconvene the meeting. My guess is that they will be satisfactory, but not to impose upon you and your cooperation and the gentleman from Chicago, I will be happy, if Mr. Miller agrees that he will respond to the questions in writing promptly, we will submit them to him in writing.

Senator SPECTER. Thank you, Senator Metzenbaum. I appreciate that.

There are other questions to be submitted. Chairman Thurmond left a long list of questions which I had just begun to ask. There are questions which have been submitted by Senator Kennedy, who asked that they be asked orally if possible, but they will have to be submitted in writing. Senator Baucus also has questions. We will propound those questions to Dr. Miller for answer in writing.

I think it is a fair arrangement that if there are any open questions to ask Dr. Miller if he would be willing to return. Chairman Thurmond started off today saying that there would be a series of occasions where Dr. Miller would be called upon to come before the committee in a variety of contexts.

Mr. MILLER. And I look forward to such opportunities.

Senator SPECTER. And I can understand why you do, Dr. Miller. [Laughter.]

Senator METZENBAUM. Mr. Miller, would it be unreasonable to ask you to respond to our questions within a week? We submitted questions to Mr. Baxter, and we have not heard from him further.

Mr. MILLER. Senator, I would only point out that there is a non-zero probability that we will be out of business the first of next week, so I cannot promise that. In fact, it would be a criminal violation, I am told, for me to respond to such questions or to engage in ordinary activity——

Senator METZENBAUM. Let us not worry about the conjecture about being out of business. You will be in business next week. Assuming you are in business, will you respond within the week?

Mr. MILLER. To that hypothetical, sir, I will respond that we shall do our very best to get you answers within a week.

Senator METZENBAUM. That is fair enough. Let me just then make one further comment. You came to an earlier hearing at our request, and we were not able to inquire of you. You have been very patient today, and I want you to know that I do appreciate the fact that you too have your agenda and time commitments. I am sorry that we have imposed upon your time, but I guess we did not have much choice about it. Thank you.

Mr. MILLER. Thank you, sir. I would like the record to show that I will be glad to stay if necessary, but I know that you do have Professor Brozen here.

Senator SPECTER. Thank you very much, Dr. Miller. And thank you, Dr. Campbell and especially Dr. Tollison. [Laughter.]

Mr. MILLER. He is our secret weapon.

[Prepared statement of Chairman James C. Miller III, and responses to questions from committee members follow:]

Prepared Statement

of

James C. Miller III
Chairman
Federal Trade Commission

Mr. Chairman and Members of the Committee: I appreciate this opportunity to appear before you today to present my views on the government's policies toward industrial mergers. The views I will present are my own and do not necessarily represent those of the Commission.

This is an extremely important issue for me and for my colleagues at the Commission. We welcome the chance to engage in dialogue on the matter.

Mergers and Guidelines

In my view, mergers play an important and often pro-competitive role in our society. Among other things, mergers, or the threat of take-overs, pressure managers to use resources efficiently and in response to the demands of consumers; they provide a means by which the activities of one firm can be combined relatively quickly and easily with those of another in order to reduce costs; and they are a means by which those who have spent time and effort and have risked their capital in building a business can sell their assets in a timely fashion to those who will turn them to best account. Although these advantages are easy to state, I would not on that score wish to minimize their overall importance.

On the other hand, mergers, particularly those involving directly competing enterprises, may also result in firms with significant market power over the prices they charge and possibly the rates and timing of innovations and product improvements. It is mergers likely to have these characteristics that should be challenged by the Federal Trade Commission, and I will vigorously pursue this course during my tenure as Chairman.

The difficulty lies in distinguishing those mergers which are likely to have adverse effects from those which are not, or in distinguishing those mergers where the adverse effects are likely to offset the advantages, since both may occur simultaneously. To identify with precision the advantages and disadvantages of any proposed merger would require an extremely thorough and technical investigation and at best would result in estimates lacking precision and using assumptions themselves subject to substantial doubt. Therefore, it makes sense to concentrate the government's enforcement resources on those mergers which are more likely to create problems than those which are not.

In order to provide guidance on which mergers need to be addressed, the horizontal merger guidelines issued by the Department of Justice in 1968 placed strong reliance on the work of economists showing positive relationships between industry profitability and levels of concentration. This general tendency, though never particularly strong, had shown up in a great many studies and ultimately provided the evidentiary base for broad challenges of horizontal mergers. In short, the argument was that horizontal mergers should be deterred, because they increase concentration and lead to higher profitability, which is a manifestation of monopoly power.

The concentration-profitability relationship greatly simplified the analysis otherwise required to go forward with a merger case: great reliance came to be placed on the market shares of the merging firms, and any resulting change in industry concentration could be taken to imply that the merger was anticompetitive. Though it was clear that errors would at times be made, in that a particular challenged merger would in fact have no anticompetitive effects, it was nonetheless felt that the relationship on which the challenge was based was sufficiently general and strong to reduce to acceptable proportions the number

of errors made. This view was reinforced, I believe, by the feeling that these errors would not be very costly, in light of the assumption that in most industries relatively very small firms were as efficient as their much larger competitors and therefore a merger leading to a larger firm probably would not contribute much to economic efficiency. Furthermore, it seems to have been felt that other and equally efficient buyers, who currently were not direct competitors, were available to purchase the firm about to be merged.

As noted above, this approach is reflected in the 1968 horizontal merger guidelines. Aside from the advantages of providing greater clarity to the business community and the antitrust bar and of limiting the discretion of the antitrust authorities, the Department's guidelines summarized then-current economic thinking on appropriate merger policy.

In recent years the Department's guidelines and the policy they embody have been subject to strong criticism. In broad terms, these criticisms relate to arguments that: (a) cases are brought where the probability of anticompetitive behavior is remote, even assuming the validity of the earlier studies on concentration and profitability; (b) the relationship between concentration and profitability is weaker (perhaps non-existent) and much less well understood than it had previously been supposed; and (c) the appropriate interpretation of this relationship is that larger competitors actually generate the higher profits by being relatively more efficient rather than by pricing anticompetitively, so that a broad challenge to horizontal mergers becomes a more costly policy than previously thought to be the case. Furthermore, it has been argued that the government's approach to merger cases has failed to give appropriate weight to factors other than market shares and concentration that are important for sensible decisions. These include: (a) realistic consideration of the time within which

entry or expansion of output can occur should a particular merger result in higher prices or other anticompetitive effects; (b) the efficiencies likely to result from a merger, (c) the constraints imposed by foreign producers and by producers of closely related products, and (d) a variety of other factors thought likely to affect the probability of successful anticompetitive behavior.

A panoply of factors affecting the economic effects of mergers and constraints on them is under serious review by the staff of the Commission. What factors should be taken into account in the analysis of any merger, the feasibility of incorporating them formally into the Department's horizontal merger guidelines, and whether the Commission's own implicit decision rules should be revised are questions now being reviewed. Although it is too soon for me to make any specific recommendations, I strongly support the Commission's efforts to improve its analysis of horizontal mergers and to adopt any changes which on the basis of solid evidence seem clearly warranted.

Conglomerate Mergers

The recent increase in conglomerate merger activity, about which two of my colleagues on the Commission, David Clanton and Michael Pertschuk, recently testified before the House Subcommittee on Monopolies and Commercial Law, is of concern to us all and naturally leads one to consider whether the antitrust laws should be applied as a blunt instrument to block conglomerate mergers. It is my view that pressures to do so should be resisted, a view which is shared by many antitrust scholars.

The acquiring of an enterprise by a firm which has interests in unrelated enterprises, unlike a merger between actual or potential horizontal competitors, has no direct anticompetitive effects. Indeed, as far as I am aware, the main complaints against the conglomerate firm relate to broader social and

political concerns, which, in my view, are outside the scope of the existing antitrust statutes.

It is often claimed, for example, that conglomerate mergers do not promote any real economic efficiencies, and so it would not be costly to society if they were proscribed. The evidence tends to show, however, that some conglomerate mergers are efficient, where others are not. In this regard I cannot emphasize too strongly the importance of competition in sorting out the efficient from the inefficient cases. Those merged firms that turn out to be inefficient will find resources harder to get and may be forced to dispose of some of their constituent parts. The efficient merged firms will succeed. This potential for efficiency gains or losses provides a powerful discipline on those proposing conglomerate mergers or arranging conglomerate merger partners. Since it is virtually impossible to determine by administrative or court proceedings which proposed mergers will be efficient and which will not, and, because the competitive process will in fact do this quickly and accurately, there seems little point in using the efficiency issue as a basis for antitrust action against conglomerate mergers.

Various other arguments have been advanced to support antitrust action against conglomerates. For example, it has been said that the firms might engage in reciprocal buying between constituent units. Such a practice could lead to greater efficiencies (for example, by reducing marketing costs) or it could lead to inefficiencies (by substituting a subsidiary's high-cost supplies for an outsider's lower-cost supplies). But if the practice leads to inefficiency, there is little reason to stop it; if it leads to inefficiency, there is little reason to suppose that it would be widely adopted or last for long since it would reduce the firm's overall profits.

These points are only made to emphasize that I believe a convincing case has not been made to support a broadside attack

on conglomerate mergers. And until it has, I think we would be wise to devote our resources to combatting clearer threats to competition. This does not mean that the Commission should not examine what upon first inspection appear as conglomerate mergers, since it may turn out that the firms are direct competitors in important markets, and this needs to be addressed as a separate matter. But I doubt that a formidable antitrust challenge in the conglomerate area is justified and to do so would seriously affect market mechanisms necessary for the transfer of assets to their most productive uses.

I should stress that I do not regard this view as inconsistent with an understanding that there are other important values to be considered apart from a narrow conception of economic efficiency. But one of these values is that we ought not charge anyone for an imaginary crime. If policy is to be based on a concern for the effects of firm size, then surely it is desirable to discover what it is about firm size that is really troublesome, and whether these characteristics result from sheer size and whether they arise in all circumstances or only in some. Even if size alone in certain circumstances is found to have undesirable social and political consequences, and these consequences can suitably be dealt with by the antitrust laws, it would still not be obvious to me that the Commission should give high priority to most conglomerate mergers, since they are commonly outranked in size by many other U.S. companies not currently engaged in significant merger activity. What I would argue is that antitrust actions only be brought when there is reason to believe that the practices challenged have serious adverse consequences for consumers and can be properly handled under the antitrust laws. This does not seem to me to have been established at present in the case of conglomerate mergers.

Vertical Mergers

As in the case of conglomerate mergers, vertical mergers generally do not involve the elimination of direct competitors, and, as a consequence, they are generally far less troublesome than horizontal mergers and their anticompetitive effects are difficult to analyze or predict. In other words, the basic underlying reason for challenging horizontal mergers -- that they pose a direct threat of less competition among rivals -- is lacking. I believe that the caution which both the Department of Justice and the Commission have shown in recent years toward challenging vertical mergers is sound and reflects an awareness of this fact.

Another caution about challenging vertical mergers is that they are commonly based on efficiency considerations. These efficiencies may stem from a desire to diminish risks or marketing costs, or they may be the result of strictly technological considerations. As a consequence, broader challenges to vertical mergers are not likely to generate many benefits in terms of preserving competition, and, therefore, on balance, such challenges are likely to raise costs to consumers.

Indeed, vertical mergers are frequently procompetitive in that the efficiencies generated by such mergers put pressure on competing firms, leading them to seek out more efficient arrangements. At times this may result in a trend to similar vertical integration by competing firms. Under these circumstances relying on a trend in vertical mergers to argue for greater antitrust enforcement would be misplaced.

Again, I do not mean to imply that large vertical mergers should not be carefully examined by the Commission, since there may be instances where such a merger may create competitive problems. But these instances require careful analysis on a case-by-case basis, and I would prefer to be convinced by evidence that the harm to consumers resulting from a proposed

merger is unlikely to be offset by any improvements in competition likely to flow from it.

I should note that the Commission is reviewing its vertical merger policy as well as the Department of Justice's vertical merger guidelines. The overall aim is to discover how our analysis can be improved in light of the recent work of economists and legal scholars in this area, whether current practices and court decisions conform to the guidelines, and, in light of all this, whether revisions of the guidelines would appear beneficial. As before, it is too early for me to discuss any specific recommendations, although I strongly support these review efforts by both the Commission and the Department of Justice.

Concluding Remarks

Under my tenure as Chairman, the Commission will vigorously enforce the antitrust laws against mergers that substantially lessen competition. I strongly believe in the desirability of this policy and will work towards its clear and sensible application.

* * * * * *

Mr. Chairman and Members of the Committee, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the Committee might have.

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

OFFICE OF
THE CHAIRMAN

January 13, 1982

The Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

This is in response to your letter of December 2, 1981, enclosing questions from Senator Specter relating to my testimony on November 19th.

My responses to Senator Specter's questions are attached as well as my responses to Senator Kennedy, who contacted me under separate cover. I am also enclosing my answers to Senator Metzenbaum's letter of November 23rd.

Sincerely yours,

James C. Miller III
Chairman

cc: Senator Specter
Senator Kennedy
Senator Metzenbaum

Questions submitted by Senator Specter

1. Can you foresee any circumstances in which you believe it would be proper for the Cabinet Council on Commerce and Trade to advise you on how the FTC should be enforcing the antitrust laws?

ANSWER: The Federal Trade Commission is an independent agency, and its members are entrusted by law with final authority to determine whether or not to take action in any particular case. On the other hand, the Commission is also intended to be an expert regulatory body, and, as such, it must be open to the viewpoints of all interested parties regarding the way in which it should perform its job. I do, therefore, consider it appropriate for the Cabinet Council on Commerce and Trade to express its views to the Commission as to how the Commission should enforce the antitrust laws, just as the Commission would welcome the views of Congress on this subject, and the views of members of the public. The ultimate decisionmaking authority in a particular case, however, rests with the Commission.

2. Do you consider the role of the Cabinet Council to include advising or directing the FTC with regard to particular matters under antitrust review?

ANSWER: As noted in response to your first question, the Commission itself is solely responsible for deciding whether or not to prosecute a particular case. I would not expect the Cabinet Council to advise the Commission with regard to particular matters under antitrust review, although I believe such advice would be appropriate in some cases, just as the Commission often receives advice and views from Members of Congress on particular matters. Of course, the immediate responsibility and authority to decide how to proceed in such antitrust matters rest with the Commission, consistent with the will and mandates of Congress.

3. Do you consider the role of the Cabinet Council to include any interference in prosecutorial and litigational decisions entrusted to the FTC?

ANSWER: As indicated in response to your first two questions, the Commission is solely responsible for deciding whether to prosecute a particular case, and how to conduct the litigation. I believe the Commission should be open to advice on these matters, but by law it retains ultimate decisionmaking authority. In addition, when a matter has entered into adjudicative status before the Commission, its rules of practice, 16 C.F.R. Section 4.7, prohibit discussions between Commissioners and outside parties regarding the merits of the case, unless such discussions are on the record.

4. Has the Cabinet Council contacted you or any other FTC commissioner with regard to decisons entrusted by law to you?

ANSWER: There have been no such contacts.

5. What contact have you had with the Cabinet Council? What involvement do you expect to have in the future?

ANSWER: Since I was sworn in as Chairman of the FTC, I have not as Chairman had any official contact with the Cabinet Council. I don't know at this time whether or to what extent I may be involved with the Cabinet Council in the future, but any such involvement will be in accord with whatever legal restrictions may exist, and be subject to the general considerations outlined in response to your first three questions.

6. In answer to written questions propounded by Senator Danforth at the time your confirmation hearing you stated that among the types of antitrust enforcement cases you would emphasize would be "acquisitions by one competitor of another, where the result would likely be a substantial diminution in the performance of the industry."

a. Does that continue to be your view?

b. Can you explain what you mean by "substantial diminution"?

c. Under what circumstances would such a substantial diminution occur?

ANSWER:

a. Yes.

b. The term "substantial diminution" was used to convey the standard set forth in Section 7 of the Clayton Act. That is, the Act prohibits those mergers whose effects "may be substantially to lessen competition or create a monopoly."

c. As a generally proposition, of primary concern would be a merger between substantial actual competitors in a well-defined market which exhibits high barriers to new entry. The Commission is currently reviewing the standards for merger enforcement and I hope that review will yield a more precise delineation of expected enforcement efforts.

7. In written testimony prepared for the hearing before this Committee on October 27, 1981 you stated:

> "it has been argued that the government's approach to merger cases has failed to give appropriate weight to factors other than market shares and concentration that are important for sensible decisions."

You then listed as one such factor "the constraints imposed by foreign producers and by producers of closely related products." Will you explain how the significant restraints posed by the foreign producers of petroleum should be factored into a consideration of a merger between two domestic petroleum firms?

ANSWER: The world price of crude oil is set by the Organization of Petroleum Exporting Countries (OPEC), a loose but effective cartel. In this context, the loss of aggressive bargainers for crude purchases in the world crude market through mergers with large companies which may perhaps be constrained from such aggessive behavior by long-term relationships with cartel member countries should be carefully scrutinized. Courts have been particularly suspicious of mergers where the eliminated firms had some unique significance. See United States v. Maryland and Virginia Milk Producers Ass'n, 117 F. Supp. (D.D.C. 1958), aff'd in part 362 U.S. 458 (1960).

8. In his testimony before this Committee on October 27, 1981, Assistant Attorney General Baxter stated that:

> "Factors other than these concentration data are relevant to the probable competitive effects of a transaction, and we accordingly are attempting to isolate the most important of these and formulate manageable standards incorporating them. Among the

> factors under consideration are the rate of technological change, the amount of capital which must be put at risk to enter the market, the stability of relative market shares over time, the durability and restorability of the product, and the growth rate of sales in the individual and related markets."

Do you agree with Mr. Baxter's statement?

How would you quantify each of these factors in assessing a proposed horizontal merger?

ANSWER: I agree with Assistant General Attorney Baxter that "[f]actors other than . . . concentration data are relevant to the probable competitive effects of a transaction . . ." Quantifying such factors is indeed a difficult task and one that has been subject to much of the review I spoke of in response to question six.

Our goal is to achieve an enforcement measure which will encompass all factors which may significantly bear on the statutory standard ("lessening of competition") without introducting undue complexity or uncertainty into the merger enforcement program. I am hopeful that the Commission will complete its work in this area this year.

9. In your prepared testimony you submit that "the main complaints against the conglomerate firm relate to broader social and political concerns, which, in my view, are outside the scope of existing antitrust statutes." What do you believe is the proper context for addressing those concerns?

ANSWER: Concerns over aggregate concentration and broader social and political complaints relating to the conglomerate merger issue are important matters that should be addressed only from the public policy perspective of the Congress and the President. The FTC simply does not possess this perspective and the antitrust laws, perhaps recognizing the Commission's limitations, do not extend the Commission's jurisdiction into these public policy areas.

10. In response to questions from the Senate Committee on Commerce, Science and Transportation in the course of your confirmation proceedings, you wrote that you:

> "believe that a major review of the antitrust laws and their public and private enforcement is sorely needed. If I am confirmed, I will work with the Administration and Congress to that end. For now, however, I believe that the current institutional arrangements should continue in force."

Is that still your view? What review of the antitrust laws and their enforcement has the FTC undertaken?

ANSWER: The quoted remarks continue to be my view. At the present time, the Commission is not conducting a comprehensive review of public and private enforcement of the antitrust laws, although as part of our own enforcement responsibilities, we are continually reassessing both our past performance and the standards that should govern our future enforcement efforts. If Congress is interested in a full review of antitrust enforcement, we would be happy to participate in it and provide whatever materials and comments are requested.

11. Are merger investigations an area in which you intend to have the FTC pull back or defer to the Department of Justice? Will the FTC under your direction vigorously employ its power under Section 13 of the FTC Act to enforce the Clayton Act?

ANSWER: The Commission does not intend to defer to the Department of Justice in the area of merger enforcement except, of course, to the degree that each agency has historically deferred to the other in particular cases pursuant to our liaison agreement. We do expect to apply more vigorous standards to our merger review process in order to weed out unlikely enforcement candidates at the pre-investigation stage. This should result in fewer merger investigations without a negative impact on the effectiveness of the overall merger enforcement program. Finally, as manifested by the Commission's recent votes to seek injunctions to prevent Mobil's acquisition of Marathon, and to prevent LTV's acquisition of Grumman, we will continue to utilize Section 13(b) of the FTC Act to enforce the Clayton Act in appropriate circumstances.

12. Do you foresee the FTC's following the Department of Justice's lead in stepping back from enforcement efforts in the area of vertical restraints?

ANSWER: It would be inappropriate for me to characterize or discuss the enforcement program of the Department of Justice. Speaking on behalf of the FTC, I expect that we will continue our program of identifying, investigating, and, where appropriate, bringing suit against vertical restraints that pose dangers to competition. We will be guided by the principle of using our limited resources where they will be most effective in combating restraints that reflect abuses of market power and may harm ultimate consumers. We do not intend to abandon our efforts in this area.

13. At your confirmation hearing, you suggested that one role you foresaw for the FTC was that of intervening before other government agencies "to present the case for competition." Can you describe examples of where and in what context you foresee this arising? Do you foresee the FTC's moving toward a more active role in commenting on and dealing with the antitrust implications of deregulation?

ANSWER: Many sectors of our economy are heavily regulated, often to the detriment of consumers. Recent experience with deregulation of the airlines and of the trucking industries has produced increased competition, improved services, and lower prices for consumers. There continue to be opportunities where deregulation will improve market performance. The Commission has a long tradition of comment, study and other intervention in areas affecting its primary concerns, competition and consumer protection. My intention is to build on past FTC efforts to advocate the benefits of competition and consumer protection before various decision makers. This will take place, for example, through testimony before Congress, comments to other agencies on rulemaking proceedings, intervention in agency proceedings raising antitrust or consumer protection issues and economic reports to the Congress, the states, or the general public. Our experience has already been that the agencies

affected or involved are anxious to have our comments. In fact, I testified on behalf of the Federal Trade Commission before the Motor Carrier Ratemaking Study Commission on November 18, 1981, in support of the elimination of antitrust immunity for ratemaking by motor carriers. The Commission's staff has also submitted comments to the Federal Communication Commission in support of a lottery system for assigning initial broadcast licenses in place of expensive and lengthy comparative hearings. Intervention before other government agencies to present the case for competition is an area in which I hope the FTC will continue to be very active in the future.

14. At your confirmation hearing you indicated that you had reservations concerning the Robinson-Patman Act, and stated that you would see that the FTC studied the Act's effect, both on business and consumers. Has such a study been undertaken? When can we expect a report from you on your study?

ANSWER: At my confirmation hearing, I stated my view that Robinson-Patman Act enforcement means pursuing cases in which an anticompetitive effect exists and in which the Commission is likely to prevail. I did not mean to imply that a specific study would be undertaken; but, rather that in acting on Robinson-Patman matters before the Commission, I would examine any alleged violation in light of its effects on both business and consumers. That examination may lead me to conclude that legislative modifications may be appropriate.

15. I understand that as of April of this year, the Commission had about 20 Robinson-Patman cases and investigations pending. How many of these are still pending? Have new investigations been undertaken or cases filed since then?

ANSWER: As of April 1, 1981, there were 33 Robinson-Patman cases and investigations pending. Since that date 20 new Robinson-Patman investigations have been initiated, while 20 investigations have been closed. The Bureau of Competition and the Regional Offices continue to have the authority to initiate

preliminary investigations of alleged violations of the Act and to close such investigations when the facts do not disclose significant law violations.

16. Do you believe that the FTC or the Department of Justice in reviewing a merger should include in its evaluation consideration of whether or not a proposed merger facilitates exploration, research, or development? If not, at what stage and by whom should such policy considerations be made?

ANSWER: Obviously such considerations should be weighed in the Commission's review of particular mergers. Despite the larger number of factors which were considered in the passage of the antimerger statutes, the central thesis underlying their enactment was to benefit the interests of consumers. Congress intended to stop incipient increases in industrial concentration from resulting in corporate entities that would be able to engage in supra-competitive pricing that would injure consumers. Although the Congessional debate did not directly address the issue of efficiencies and innovation stemming from particular mergers, consideration of the existence or absence of these factors in reviewing such mergers is a part of the review process at all stages within the Commission.

17. In enacting the Hart-Scott-Rodino amendments to the Clayton Act, Congress recognized the importance of stopping an anticompetitive merger before it occurs because divestiture is not an adequate remedy, and structured a mechanism to force the enforcement agencies to deal with mergers on a "before the fact basis." How would the hold-separate agreement proposed by Mobil in connection with its bid for Marathon avoid the problems normally associated with divestiture?

ANSWER: The response to this question, along with those to questions 18 and 20 will be combined in this answer. The questions relate to the Mobil-Marathon hold-separate agreement proposed by Mobil.

The Commission did not approve or enter into any hold-separate agreement with Mobil Corporation. Rather, the Commission decided that it had reason to believe that the acquisition, if consummated, would substantially lessen

competition in sale and distribution of gasoline and middle distillates. The Commission also determined that it had reason to believe that the increased petroleum pipeline concentration resulting from the acquisition would exacerbate the likely anticompetitive effects in wholesale gasoline and other distillate products. Accordingly, the Commission instructed its staff to seek a preliminary injunction against the merger, unless and until such time as a federal district court would approve a divestiture which would both eliminate the Commission's concerns over the anticompetitive horizontal overlaps and assure that the divested entity would be a viable and effective competitor in the affected markets.

18. If the hold-separate agreement proposed by Mobil is accepted, it is not difficult to imagine the willingness of future parties to future horizontal mergers to propose to enter into the same sort of hold-separate agreements, and except in the most blantant of horizontal cases, it is difficult to see how the Commission staff could refuse to do so in light of a Mobil-Marathon precedent. Wouldn't this virtually eliminate effective pre-merger enforcement?

ANSWER: Please see the answer to Question 17.

19. Do you believe that a Mobil-Marathon merger could only be the first in a series of oil company mergers? Is this a factor which you believe should be considered in evaluating a Mobil-Marathon merger?

ANSWER: We are of course concerned over the question of a "merger wave" among petroleum and natural resource companies. However, it is not necessarily true that a merger such as Mobil-Marathon, which the Commission has sought to enjoin under Section 13(b) of the FTC Act, will induce subsequent mergers in the same industry. A particular merger may be motivated principally by considerations unique to that transaction, such as certain efficiencies resulting from the particular combination of firms. On the other hand, broader economic considerations and forces may affect the industry, such as an adjustment in the allocation of resources as a result of deregulation.

Needless to say, in any event the Commission's staff is studying the dynamics of the petroleum industry, based upon its substantial experience in petroleum competition issues over the last decade and more. Should the Commission discern a trend toward anticompetitve mergers in the energy and natural resource areas, appropriate action can be taken under Section 7 and 7A of the Clayton Act, 15 U.S.C. Sections 18 and 18A, and Section 13(b) of the FTC Act, 15 U.S.C. Section 53(b), to prevent anticompetitive harm before it occurs.

20. A draft of the Mobil-Marathon "Hold Separate Agreement" provides in the "Premises" of the agreement:

> NOW, THEREFORE, the parties have agreed upon the understanding that the Commission has not yet determined whether the acquisition will be challenged, and in consideration for Staff's not recommending to the Commission that a temporary restraining order or preliminary injunction be sought prior to the effective date of the Acquisition, to enjoin or otherwise delay the consummation of the transaction, Mobil will hold the assets of Marathon separate and apart from its own, upon the following terms and conditions....

I understand that at a meeting with Senate Judiciary staff held November 16, Mr. Campbell stated that he would not recommend that the Commission enter into the hold-separate agreement unless the decision had first been made not to seek a preliminary injunction. However, if the Commission has decided that the facts do not warrant seeking a preliminary injunction, what justification would exist for the hold-separate agreement? If the Commission determines that it has a case and should seek a preliminary injunction, would resorting to the hold-separate agreement not only contradict Mr. Campbell's representations but also the Commission's enforcement responsibilities? It appears that there is no set of circumstances in which the hold-separate approach is appropriate. Would you please describe a hypothetical situation in which such a hold-separate agreement would be acceptable to the Commission?

ANSWER: Please see the answer to Question 17.

21. I understand that the FTC has endorsed budget cuts that would bring its 1982 budget to $61.1 million instead of its FY 1981 budget of $70.8 million and that you have stated that the Commission could survive on $50 million. These cuts according to Commissioner Pertschuk would "represent a substantial reduction in the capability" of the Commission "to enforce the law." He further stated that the cuts would result in an 18% reduction in the number of attorneys working with the Bureau of Competition's antitrust enforcement mission which "would result in significantly reducing resources available for enforcement of the Robinson-Patman Act prohibition against price discrimination, the

Clayton Act prohibition of anticompetitive mergers and the investigations of anticompetitive problems in the food, petroleum, and health care industries."

Do you agree? In what areas do you disagree?

ANSWER: While the current fiscal 1982 level is likely to be substantially higher than the $61.1 million figure, that hypothetical level would require a refining of Commission resource allocation, rather than substantial policy changes regarding the statutes we enforce. For example, the proposed budget modifications in support of the $61 million budget reflect a more intensive scrutiny of ongoing and future investigations to assure that limited resources are devoted to those alleged violations that are most harmful to the consumer and the most amenable to efficient, primarily market-oriented remedies. Budget reductions will require careful case generation in the consumer protection area as well, and more focused Commission decisions regarding priorities. Based on recent experience that indicates a need to narrow many Commission rules from the scope originally proposed, resources planned for developing and enforcing rules have been reduced.

22. The FTC's proposed budget for FY 1982 now stands at $68.1 million. At this level what reductions or cutbacks in antitrust enforcement efforts do you foresee?

ANSWER: The reduction to this level will have little effect on the directions in antitrust enforcement that the Commission has been developing for several years and they will remain very important features of the Maintaining Competition Mission. However, there will be greater focus on the competitive problems that cause the greatest harm to consumers and the formulation of the most cost-efficient remedies for these problems. Further, economic analysis will play an increased role at all levels of the Commission's antitrust work.

Moreover, the Commission does contemplate some important new activities in the antitrust area. For instance, the staff is

beginning an assessment of each extant Commission antitrust order's current impact on competition, so as to be able to recommend to the Commission whether certain orders are suitable candidates for modification or vacation in light of present market conditions.

23. Do these cuts, down to $53.8 million in FY 1984, signal a turn away from the FTC's role as an active enforcement agency toward one which concentrates primarily on economic analysis?

ANSWER: While more economic analysis will be employed in both missions, our primary aim remains the enforcement of antitrust and consumer protection laws. The Commission's enforcement activities, of necessity, will simply become more efficient through careful case selection.

Questions submitted by Senator Kennedy

1. You have indicaced that you think the FTC placed too much emphasis in the past on vertical restraints of trade such as resale price maintenance, and Robinson-Patman Act violations, or vertical mergers. At your confirmation hearings you agreed your job was to enforce the law, until Congress changed it, even if you disagreed with its wisdom. But you claim that in allocating reduced resources, you may end up cutting back on cases which you think have less economic significance. Doesn't that really give you a license to do precisely what you promised the Senate you would not do; to effect a substantial repeal of laws you dislike by non-enforcement, which is justified as "resource allocation?"

ANSWER: I do not regard the concept of resources management as a smoke screen for an effective repeal of certain antitrust laws. As an agency with limited resources and a public interest mission, the FTC has an obligation to use those resources so as to obtain the maximum benefit for the public. Such practices as horizontal mergers and agreements among competitors present the most serious dangers to competition and consumers, and accordingly, I have directed that additional resources be shifted into those areas.

Although resale price maintenance can pose a danger to competition in many cases, I believe its frequency has diminished as a result of antitrust litigation and the repeal of fair trade laws. Additionally, I am not sure that all the firms the FTC has looked at in this connection have been proper targets for enforcement activity. As a matter of discretion, I would prefer to investigate and bring cases against companies with significant market power at either the buyer or the seller level. I do not intend, however, to abandon this area of enforcement.

Roughly the same considerations apply to Robinson-Patman enforcement. Although some price discrimination can reflect abuse of a dominant or powerful market position, in many cases the practice either may have little effect on competition or may contribute to overall efficiency. I am concerned that the Robinson-Patman Act not be enforced in such a way as to rigidify prices or to bolster the effects of oligopoly pricing by

discouraging sellers from breaking with the oligopoly price. I therefore expect the Commission to use its discretion carefully in selecting Robinson-Patman cases. This area also will not be abandoned.

The Commission has been quite inactive in the past several years in the area of vertical mergers, and I see little need to change that policy. This is not because no harm can ever result from such mergers but because it is generally agreed that the conditions under which harm to competition will result are rare. However, the Commission staff will, of course, continue to examine reported mergers for evidence of foreclosure, a supply or price squeeze, or other vertical problems that may be possible consequences of mergers.

I believe that the Commission's enforcement record over the years will speak for itself and will be the best guide for Congressional oversight committees to judge whether the Commission is upholding its statutory obligations.

2. In your budget plans, how much resources are you planning to shift away from vertical restraints on trade which hurt small business and the consumer, such as resale price maintenance and Robinson-Patman violations? I understand that you plan to switch substantial resources from those areas to price-fixing and horizontal mergers. Won't that send a signal to private business that some of our antitrust laws have been put on starvation budgets and won't be enforced?

ANSWER: The FTC does not plan to abandon its vertical-restraints enforcement program. Therefore, I do not believe a meaningful signal to this effect is being transmitted to business. The deterrent effect of our continued scrutiny will, I believe, continue to discourage many pricing and other plans that might violate the law. Further, to the extent that price discrimination can be efficient and pro-consumer, clearer signals from the FTC regarding our enforcement intent may encourage such types of behavior and benefit the economy.

3. You indicate in your testimony that the FTC and Justice should use caution in challenging vertical mergers because they are commonly based on efficiency considerations. That is on page 9 of your statement. Isn't it true that under the Clayton Act if a merger, whether horizontal or vertical, would tend to lessen competition substantially, then it is unlawful, even if there are some efficiency arguments which can be made in its behalf? It seems that you are seeking to substitute your judgment about preserving competition for the judgment of Congress now in the antitrust laws.

a. Your Commission is now investigating the Mobil Oil Company effort to acquire Marathon Oil Company. I know my colleague from Ohio will want to review that with you in detail, but let me ask you two questions. First, you have until December 10 to decide under the Hart-Scott-Rodino law whether or not to seek a restraint of the merger, is that correct? If you decide not to seek a restraint will you provide this Committee with an explanation of the Commission's judgment, or at least of your own? Second, in your own view, should the Commission merely review the merger under the percentage guidelines, or should you also give significant weight to the likelihood such a merger would significantly lessen competition in the oil marketing industry by triggering a number of additional similar mergers? Is that a relevant factor for you?

b. Let me return to the question of vertical restraints on fair competition other than mergers, including resale price maintenance. In the Levi Strauss case, the FTC won a settlement involving resale price maintenance on popular blue jeans, which the Commission estimates saved consumers 75 million dollars. I think it's important that businessmen not feel you're tossing that kind of case on the junk pile because you think vertical restraints of trade are merely an efficient way of doing business. What kind of message are you sending industry in these areas where you are slashing the Commission's budget?

ANSWER: As a general proposition, it is correct that where the requisite statutory lessening of competition has been found likely to result from a merger the courts have not accepted enhanced efficiency as a defense. My point goes beyond this, however. First, the efficiency consequences of a merger may bear significantly on the initial inquiry itself, i.e., whether the transaction is likely to lessen competition. The Supreme Court recogized this fact in Brown Shoe Co. v. United States, 370 U.S. 294 (1962), where it noted that Congress, in enacting Section 7, did not intend to preclude "a merger between two small [companies]... [which would] enable the combination to compete more effectively with larger corporations dominating the relevant market..." Id. at 319. Second, the Commission

has never pursued each and every merger which technically meets the statutory prohibition. The Commission must continue to exercise prosecutorial discretion so as to utilize its limited enforcement resources on those matters most consistent with the public interest. Regardless of the role efficiency concerns may play in the litigation process or in formal enforcement guidelines, I believe that a merger's likely impact on efficiency is a proper factor for the Commission to consider in weighing the public interest in a proposed enforcement action.

a. Obviously, analysis using any accepted set of percentage guidelines is but the first step in evaluation of a merger. Over the last decade or more, the Commission has conducted a large number of studies and investigations of energy and other natural resource related matters and has been involved in a number of significant litigations. Through this process, the Commission has developed an appreciation for the complexity as well as the importance of the issues involved. This experience is the primary source used in examining mergers in the energy and natural resource industries. Should the Commission discern a trend toward anticompetitive mergers in these markets, appropriate action can be taken under Sections 7 and 7A of the Clayton Act, 15 U.S.C. §§18 and 18A and Section 13(b) of the FTC Act, 15 U.S.C. §53(b), to prevent anticompetitive harm before it occurs. Such a provable trend would be a relevant consideration

b. I understand that the Levi Strauss consent was one of the Commission's most significant accomplishments of recent years and led to major benefits to consumers. I have not said that this case should be tossed on the "junk pile." Nor do I think vertical restraints are invariably efficiency-producing. I simply would like the Commission to take a close look and apply sound economic analysis to its vertical-restraint cases. I expect that such analysis will support the concepts behind many of our past initiatives in this area.

4. You also are taking substantial resources away from monitoring advertising fraud, isn't that correct?

Don't you think that as the economy gets tighter there will be increased temptation for some hard pressed companies to engage in advertising practices that may deceive the public -- and at a time when the poor can hardly afford to lose money through fraud? The same is clearly true for your planned cutback in challenging illegal consumer credit practices.

ANSWER: I intend to maintain a vigorous program for pursuing false and deceptive advertising. Advertising cannot fulfill its vital role in a competitive economy unless it is truthful. I have addressed this more fully in two speeches before the Association of National Advertisers and the American Advertising Federation. Copies are found as Attachments 1 and 2 respectively. Budget reductions in advertising enforcement programs generally reflect organizational efficiencies planned within the Bureau of Consumer Protection. Consolidation of the currently separate programs, for example, into a single unit that monitors all advertising is expected to make more efficient and effective use of these resources. In addition, some savings will be realized through the consolidation of some regionally initiated advertising cases in the Bureau of Consumer Protection Washington office.

I do not know whether fraud and deception increase with declines in the economy. Vigorous Commission action is necessary at all times to assure that such practices do not occur.

I intend to pursue all cases involving allegedly illegal consumer credit practices that are currently in litigation. Enforcement of the credit and debt collection statutes we administer will continue. To remain effective, such enforcement will probably require fewer new investigations than in previous years because of the deterrent effect created since the Commission began its enforcement of these acts.

5. Have you made plans to close any regional offices of the Commission? (Newspaper reports suggest the proposed budget would require closing 3 or 4 of the 10 regional offices.) I would like your staff to sit down with a representative from my office to discuss any planned elimination of regional offices or major reduction of personnel in them. They have helped the Commission play a more effective role in protecting consumers and ensuring competition in all areas of the country. And if there are cuts, they should be spread evenly across the country.

ANSWER: Yes, the Commission has approved (Commissioner Pertschuk dissenting) a budget proposal for fiscal year 1982 that contemplates a reduction in Regional Offices from the current number of 10 offices to six by the end of fiscal year 1982, and a reduction in the Regional Office workforce from approximately 300 today to 150 by the end of fiscal year 1982.

However, these plans are being held in abeyance pending several developments:

(1) Final Congressional action on our appropriation for fiscal year 1982. The Commission is now operating under a Continuing Resolution until March 31, 1982;

(2) A thorough evaluation by staff of the performance of each Regional Office and its planned activities for the future, based on reports prepared by each regional office; and

(3) Finalizing my own specific conclusions regarding appropriate action on Regional Offices, based on visits to those offices which I have been conducting but have not yet completed.

I have directed Mr. Larry Harlow, Director of our Office of Congressional Relations, to be ready to provide any assistance your staff requires on this matter. He can be reached at 523-3620.

QUESTIONS SUBMITTED BY SENATOR METZENBAUM

1. Please provide us with the empirical or other factual data that underlie "the arguments that . . . . (c) the appropriate interpretation of this relationship is that larger competitors actually generate the higher profits by being relatively more efficient rather than by pricing anticompetitively, so that a broad challenge to horizontal mergers becomes a more costly policy than previously thought to be the case."

ANSWER: The literature on the relationship between concentration and profits is extensive. A recent review of this literature is contained in the attached paper, "A Review of the Economic Basis for Broad-Based Horizontal Merger Policy" prepared by Dr. Paul Pautler, an economist at the FTC. 1/ (See Attachment 1.)

The paper reviews the state of our knowledge about the concentration/profitability relationship in 1968 when the Department of Justice issued its initial set of horizontal merger guidelines. As discussed in Dr. Pautler's paper, the studies conducted since that time suggest that the strength of this relationship is much lower than previously thought. 2/ Moreover, the traditional understanding of the relationship that remains has been the subject of substantial criticism. As Dr. Pautler notes, much current literature suggests that when concentrated industries are highly profitable, that profitability is due to the relative efficiency of the largest firms.

In general, the research summarized in Attachments 1-7 indicates that one should give less credence to alleged problems asscciated with concentration and market dominance.

1/ This paper is a working draft and has not been adopted by the Commission. It does not necessarily reflect the views of the Commission, individual Commissioners, or any other member of the FTC staff.

2/ I have attached a review of recent evidence obtained from line-of-business data. This evidence lends even less credibility to the hypothesized relationship between level of industry concentration and rate of industry profitability.

2. Please provide us with any empirical studies or other data showing that merger-created efficiencies are widespread.

ANSWER: As with the profits/concentration literature, the merger/efficiency literature is substantial. Attachment 2 is a review of such studies prepared by Dr. Alan A. Fisher and Robert H. Lande, Esquire, of the Commission staff. 1/ These studies found that there are efficiencies created by some, but not all, mergers. As the authors note, there are difficulties inherent in attempts to quantify efficiency gains from mergers, and each of the studies reviewed is subject to criticism for one or another reason. One major problem (for purposes of these studies) is that the law has prevented the types of mergers (horizontal and vertical) that are most likely to create efficiencies. A major problem is that such studies are inevitably based on evidence derived from mergers that have actually taken place. Since the law has prevented the types of mergers that are most likely to create efficiencies, the evidence is likely to understate the full extent of possible efficiencies.

1/ This paper,"Efficiency Considerations in Merger Enforcement", is a working draft produced by Alan A. Fisher, a staff economist and Robert H. Lande, a staff attorney. It has not been adopted by the Commission and does not necessarily reflect the views of the Commission, individual Commissioners, or others on the FTC staff.

3. Please provide us with empirical studies or other data showing a relatively quick and easy combination of the activities of one firm with another that reduced costs, or any other facts underlying your statement on p. 1.

ANSWER: Besides Attachment 2 by Fisher and Lande, please consult Attachment 3, a study by Dennis Carlton, William Landes, and Richard Posner, entitled "Benefits and Costs of Airline Mergers -- A Case Study." This latter work gives an excellent example of a merger that appears to have conferred substantial efficiencies leading to consumer benefits in the form of superior service. 1/

1/ D. Carlton, W. Landes, and R. Posner, "Benefits and Costs of Airline Mergers: A Case Study," Bell Journal of Economics, 11 (1), Spring 1980, 65-83.

4. Please explain why the Supreme Court's decision in the Brown Shoe, Philadelphia Nat'l Bank, Von's, Pabst and General Dynamics cases don't require you to manifest a concern for small business, local control, and aggregate concentration.

ANSWER: The terms of Section 7 of the Clayton Act declare illegal only those acquisitions whose effects "in any line of commerce in any section of the country . . . may be substantially to lessen competition, or tend to create a monopoly." The subsequent case law indicates that the terms "line of commerce" and "section of the country" require a showing of anticompetitive effect in specifically defined product and geographic markets. Whatever Congress' concern, it passed a statute that predicated illegality on a reduction of competition in a particular market or markets.

Despite the use of fairly broad language to condemn the economy-wide effects of mergers, the Supreme Court's merger cases, such as Brown Shoe and the others cited in your question, rest their findings of illegality on industry-specific effects. For example, Brown Shoe, often cited for its expansive discussion of the pro-small business and anti-concentration motives behind amended Section 7 of the Clayton Act, also contains the classic discussion of the proper delimitation of the boundaries of product and geographic markets. The Court found the merger at issue illegal because of its anticipated effects on competition. The same is true of the other cases you point to; in each one, violation was found on the basis of harm to competition.

Thus, although I may share a concern for the values you mention in your letter, the Commission and the courts are constrained, by the language of the relevant statute and by a consistent body of predecent, to be guided by market-specific competitive concerns.

5. Please provide us with empirical studies or factual data documenting the view that seems to be put forth on pp. 9 and 10 of your statement that vertical mergers generally result in efficiencies and that these improve competition.

ANSWER: The theoretical literature indicates that in most cases firms that choose to integrate vertically do so for reasons of increasing efficiency. Efficiency is enhanced by reducing the transactions that must be conducted to purchase or sell. 1/ In limited circumstances and under certain restrictive conditions, vertical integration may have anticompetitive results, in the sense that prices to consumers are increased. 2/ It is also possible that in some instances vertical integration for efficiency purposes can disadvantage competitors who are not integrated and whose costs are therefore higher. In such instances the disadvantaged firms may themselves seek to integrate so as to remain competitive. Such effects are generally desirable in a competitive economy that benefits consumers by rewarding the most efficient methods of production. 3/

1/ See O.E. Williamson, "The Vertical Integration of Production: Market Failure Considerations," American Economic Review, Vol. 61 (1971), pp. 112-123; O.E. Williamson, Markets and Hierarchies: Analysis and Antitrust Implications (New York: Free Press, 1975); F.R. Warren-Boulton, Vertical Control of Markets (Cambridge, Mass.: Ballinger, 1978).

2/ See Warren-Boulton, supra, n. 1.

3/ See Sam Peltzman, "Issues in Vertical Integration Policy," in F.J. Weston and S. Peltzman, eds., Public Policy Towards Mergers (Pacific Palisades, Cal.: Goodyear, 1969).

Empirical studies of vertical integration also suggest that vertical relationships generally increase efficiency. Economists and business historians who have investigated the causes and effects of vertical integration using a case study approach have found few instances in which competition was harmed, and many instances in which vertical integration enhanced efficiency. In most instances in which competition was adversely affected, vertical integration facilitated the aggrandizement of horizontal market power remediable under the antitrust laws. 4/ In addition to these case studies, we also have some econometric evidence on the effect of vertical integration. This statistical evidence shows that vertical integration tends to increase efficiency and, therefore, has a procompetitive effect. 5/

4/ For example, see F.M. Scherer, Industrial Market Structure and Economic Performance (Chicago: Rand McNally, 1980), Ch. 10; A.D. Chandler, The Visible Hand: The Managerial Revolution in American Business (Cambridge, Mass.: Harvard University Press, 1977); and Peter Temin, "Chandler's The Visible Hand," Bell Journal of Economics, Spring, 1978, pp. 297-303.

5/ Anticompetitive effects of vertical integration would be implied by higher profits for both firms and industries. See Howard H. Newman, "Strategic Groups and the Structure-Performance Relationship," Review of Economics and Statistics, August 1978, pp. 417-427; and Mark E. McBride, The FTC Policy Towards Vertical Mergers: The Case of Cement and Concrete, unpublished Ph.D. dissertation, Washington University, St. Louis, 1979. Both Newman and McBride show that vertical integration can have pro-competitive effects even when individual firms adopt it for anticompetitive purposes.

6. In view of the unbroken line of Supreme Court decisions holding resale price maintenance to be per se illegal, please explain why you plan "a look at resale price maintenance [to] see whether there are anticompetitive consequences of the kinds of things that are proposed."

ANSWER: Economic theory suggests that resale price maintenance (RPM) can often lead to efficient production and distribution. While there are economic theories suggesting that RPM can be anti-competitive when imposed in the context of retailer or manufacturer collusion, there are also economic theories that suggest RPM may be motivated by, and has resulted in, pro-competitive or efficiency-enhancing efforts. These latter theories suggest that when RPM is imposed unilaterally by a manufacturer, the likely result is to enhance the efficiency of distribution. The effects of a particular instance of RPM will therefore depend on which alternative explanation makes the most sense; and that determination will essentially be an empirical matter.

There is a fairly strong consensus among economists that there are plausible alternative theoretical explanations for RPM. 1/ The consensus is weaker as to which explanation is the most relevant empirically. Unfortunately, because of the per se illegality of RPM, it is often difficult to determine from the legal records which economic theory seems most likely to have applied. It is fair to say, however, that at this time there is no substantial body of empirical evidence that suggests that RPM always leads to anticompetitive effects. Therefore, although at this point I do not take issue with the current per se interpretation of the law, the evidence does suggest that fewer resources should be devoted to RPM enforcement.

1/ L.G. Telser, "Why Should Manufacturers Want Fair Trade?", Journal of Law and Economics, October, 1960; R.H. Bork, The Antitrust Paradox, Basic Books, N.Y., 1978; R.A. Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality", University of Chicago Law Review, 1981; J. Gould and L. Preston, "Resale Price Maintenance and Retail Outlets", Economica, August, 1965; also see the exchange between Profs. Bork and J.R. Gould and B.S. Yamey in the Yale Law Journal, 722 (1967), 731 (1967), 936 (1968), and 950 (1968). Also, see Justice White's spearate but concurring opinion in Continental T.V., Inc., v. GTE-Sylvania, Inc., 433 U. S. 36 (1977), cited in ATRR No. 819, June 23, 1977, p. H-9.

7. Please provide us with any empirical studies or other data supporting the following statement in the FTC Transition Team Report: "that price cutting is a serious problem is dubious on both theoretical and empirical grounds."

ANSWER: The empirical literature indicating a concern over predatory pricing is sparse. That which does exist indicates that predatory pricing is uncommon enough that predatory conduct "should be well down the priority list of antitrust authorities" 1/ (See Attachment 4.) Further, Donald Turner, one of the important advocates of predatory pricing rules, has argued that while some predation may exist, the dimensions of the problem are not particularly serious. 2/ (See Attachment 5.)

A substantial literature on the theoretical level has been developed concerning the feasibility of predatory pricing as a profitable market strategy. 3/ What has become clear from this work is that simple price predation is generally not a viable market strategy. 4/ This is true because the predator is likely to incur substantially larger losses than its victim as the result of pricing below cost. Given the infeasibility of simple price predation, much more complex (and possibly less likely) forms of behavior are required before predation may be a profitable strategy for a dominant firm. While there is current work on the conditions conducive to profitable predatory behavior, in my opinion they have yet to be sufficiently defined to base legal cases on them.

1/ K. Elzinga, "Predatory Pricing: The Case of the Gunpowder Trust", Journal of Law and Economics, 13(1), April, 1970, pp. 223-40; also, see J. McGee, "Predatory Price Cutting: The Standard Oil (N.J.) Case", Journal of Law and Economics, 1, 1958, pp. 137-169. These articles are found at Attachment 4.

2/ See the transcripts of a roundtable discussion on predatory pricing at pp. 633-37 and pp. 663-65 in S. Salop, ed., Strategy, Predation, and Antitrust Analysis, FTC, September, 1981.

3/ For discussion of virtually all points of view, see S. Salop, ed., Strategy, Predation, and Antitrust Analysis, FTC, September, 1981; and D. Greer, ed., The Journal of Reprints for Antitrust Law And Economics, 10(1), 1980.

4/ For a discussion of the view that price predation is a viable strategy, see F. Easterbrook, "Predatory Strategies and Counterstrategies," 48 U.Chi.L.R., 1981, 263-337.

8. Please provide us with the names of all small business groups with whom you have met since taking office, together with the dates, duration and subject matter of such meetings.

ANSWER: On October 19, 1981, I met with the Small Business Legislative Council's Antitrust Committee. This meeting lasted approximately two hours, and the topic was antitrust policy.

I met with the American Business Conference on October 20, 1981, for over an hour during which time general FTC issues were discussed.

On November 9, 1981, I spoke to the National Conference for State Officials and Legislators on State Small Business Initiatives, sponsored by SBA's Chief Counsel for Advocacy, on regulatory issues and the FTC generally.

On December 9, 1981, I met with representatives from the following small business organization: National Federation of Independent Businesses, National Small Business Association, National Association of Women Business Owners, National Home Furnishings Association, Direct Mail Marketing Association, Direct Selling Association, National Association of Home Builders, National Association of Retail Grocers, National Association of Realtors, and Credit Union National Association. This meeting lasted over an hour and a half, and the topics covered included merger/antitrust policy, consumer protection issues, and other FTC activities generally.

9. In your October 26, 1981, press conference, you expressed grave reservations about the FTC's substantiation rule because the costs involved in substantiating a claim could have a chilling effect on advertising. Please provide us with the relevant costs referred to and the factual basis for your belief that those are in fact the relevant costs.

ANSWER: I have expressed four concerns about the Commission's advertising substantiation program. First, I am concerned about the Commission's requiring that substantiation be prepared in advance. It's a little like having the Internal Revenue Code read that a taxpayer is guilty of tax evasion if he or she did not have the relevant "package" of evidence ready for inspection the moment the return was filed, even though every figure could in fact be documented. Second, the line between claims that require substantiation and those that do not may not have been drawn with sufficient clarity. Third, the Commission may have had too great a tendency to see implied claims in an advertisement that contort the usual meaning consumers would attach to the words used in the ad. Finally, I am concerned that the Commission may, in some instances, have required too much evidence in substantiation of claims.

When these problems do occur, it is clear that they also impose costs. Advertisers are required to substantiate claims when the Commission itself does not believe substantiation is necessary, or they substantiate "claims" that consumers would not believe were made, or they spend more on developing

substantiation data than necessary to protect consumers. These expenditures are inevitably passed on to consumers. The only way the program could fail to impose costs is if it only requires advertisers to act as they would ordinarily act anyway. If so, the program is unnecessary.

To some extent, advertisers can avoid the costs of substantiation by making claims that do not require evidence for support, such as "our product adds zest to your life." If such claims are effective sales tools, advertisers may use them instead of more substantive claims that at least some consumers would find more useful. If the increased costs of substantiation lead advertisers to reduce the factual content of their claims, then the program undercuts its basic goal, which is to improve the information available to consumers.

Although I am convinced that advertising substantiation is not costless, I have not yet reached firm conclusions as to whether the costs of the program outweigh the benefits it produces. No data on these costs has even been assembled, an omission that I intend to rectify. Only with better information on the benefits and costs of substantiation can we decide whether changes are appropriate in the program.

Since my press conference, I have explained my views on advertising more fully in speeches before the Association of National Advertisers and the American Advertising Federation. Copies of these remarks are found at Attachments 6 and 7.

10a. Do you believe that the FTC's substantiation program prior to your chairmanship has in fact been so "tight" that producers are providing only "top-of-the-line kind of product[s]" and that "people who would like to purchase a much lower-priced and perhaps not as high a quality product" are being "deprived of that opportunity." (Press conference 10/26/81.)

b. If you do, please set forth the evidence for that belief.

c. If you do not, please explain why you have suggested what many have interpreted as a weakening of that program.

ANSWER: I have no definitive evidence at this time that the FTC's product defects program has been so tight as to supress all but "top-of-the-line" products. I do believe, however, that such a result is a possibility from such a program, and one that I intend to guard against very carefully. Cases against lower quality products sold for lower prices to consumers who know what they are getting should not be pursued.

The proper role for a defects program is to protect consumers from producers of lower quality products who falsely and deceptively represent that their wares are of high quality. Such practices injure consumers who seek high quality, and provide no benefits to those who are willing to accept lower quality for less money. I intent to pursue such cases vigorously.

IN ORDER TO REDUCE PRINTING COSTS, THE ATTACHMENTS REFERRED TO IN CHAIRMAN MILLER'S RESPONSES WERE PLACED IN COMMITTEE FILES AND ARE AVAILABLE FOR REVIEW.

ATTACHMENT 1

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

****

FOR RELEASE 6:30 P.M. (EST) NOVEMBER 10, 1981

****

REMARKS OF CHAIRMAN MILLER*

before the

ASSOCIATION OF NATIONAL ADVERTISERS

San Francisco

November 10, 1981

Thank you very much for this opportunity to share with you some of my preliminary views on the Commission's role in advertising. I especially welcome tnis opportunity, since there appears to be considerable confusion over just what those views are!

Before giving you my views, however, I want to emphasize two things. First, just how these views should be translated into appropriate policy hinges on what the evidence shows. Whether the Commission should change its policies toward advertising depends on the relevant benefits and costs to society of doing so, and this must be considered on a case-by-case basis. Second, any formal change in Commission policy would have to be approved by a majority of the Commission. As opportunities arise to decide particular advertising cases, my colleagues and I will examine the evidence very carefully in light of our Congressional mandate. Only then might there be formal changes in Commission policy.

* The views expressed are those of FTC Chairman James C. Miller III. They do not necessarily reflect the views of the Commission or other Commissioners.

As I have noted in the past, advertising plays an important role in our competitive economy. It is one of the principal means by which information is communicated in the marketplace, and thus is a key element in maintaining competition and assuring an efficient allocation of the nation's resources.

Although not always readily apparent, all advertising provides information. It may be only a reminder that a product or service is available. It may communicate information about products and services previously unknown to the consumer, whether they be interest-free checking or non-slip decals for the bathtub. Or, it may explain the advantages of one brand over another, as in "brand X gets more mileage than its nearest competitor," or "XYZ Airlines has the lowest fares to Florida." Armed with information provided by advertising, consumers are in a better position to choose those products and services that provide them with the greatest possible satisfaction.

Advertising benefits producers as well, for it enables them to match their own unique offerings with those consumers who find their particular products and services most attractive. Of especial importance is the role of advertising in facilitating the emergence of new competitors, and thus the maintenance of a viable competitive environment. Although serious debate within the economics profession continues, there is substantial and increasing evidence that advertising facilitates the entry of new firms and new products. Even advertising's harshest critics would probably agree that without advertising there would be a slowing of the rate of entry of new firms and the rate of introduction of new innovative products.

All of the above, of course, assumes that advertising will be reasonably truthful. I say "reasonably", because "reasonable" people can differ, and often do, over what constitutes "truth". But let me be very clear: truthful advertising is a highly desirable goal, and as Chairman of the Commission I will pursue it with vigor.

The relevant question is how best to achieve truthful advertising. The starting point should be a realization that the Commission is only one of the actors in this drama. Companies have incentives to make sure their advertisements are truthful even without government sanctions. A company's reputation is a valuable asset. Reputations are built by selling products that deliver on the claims made for them. Reputations built on years of good performance can be destroyed very quickly by promises that cannot be fulfilled. Advertisers cannot fool most consumers very often or very long, and when consumers discover they have been fooled they have a propensity to take out their frustrations at the cash register. Products which are frequently purchased and easily evaluated that do not reasonably perform "as advertised" do not perform at all for very long.

Companies must also take care to assure the truthfulness of their advertising to avoid lawsuits from slighted competitors, who are usually the first to feel the brunt of misrepresentations of competing products and services. Under the Lanham Act competitors can sue for injunctive relief and monetary damages whenever a company makes a false claim about its own product or service. Although Lanham Act cases are not common, the prospect constitutes an added incentive for firms to be truthful about their advertising claims.

One of the most significant inducements to truthful advertising is the industry's own self-regulation. The National Advertising Division of the Council of Better Business Bureaus and the National Advertising Review Board currently process a large volume of cases and achieve an exceptional degree of cooperation from advertisers in voluntarily changing potentially deceptive ads. The expeditious nature of this process avoids much needless friction between government and business and leads to improved accuracy in advertising. I applaud these efforts and

promise my cooperation to assure they accomplish their objectives without anti-competitive consequences.

To complement these mechanisms, the Commission can, and should, play a constructive role. Inevitably, objectionable claims will slip through private monitoring and industry self-regulation processes. When they do, the Commission should stand ready to prosecute firms that are guilty of fraudulent and deceptive advertising practices. I assure you that as Chairman of the Commission I will expend considerable effort in this direction. Not only does this policy protect consumers and honest competitors, it also reinforces private monitoring and self-regulatory efforts.

So much for the first pillar of the Commission's contemporary approach to advertising - that is, the prosecution of false and deceptive advertising. As you know, I have questioned certain premises of the second pillar of the Commission's current policy: substantiation.

Ever since the Pfizer decision of nearly a decade ago, the Commission has required companies to have a "reasonable basis" for factual claims about their products and services. I have no problem with the concept that an advertiser be required to substantiate a claim, especially in the face of indications that a claim is false or deceptive. Consumers should be able to expect that when an advertiser makes a claim, the advertiser has reason to believe that the claim is true. Indeed, sound business judgment would seem to dictate that firms possess solid foundations for their factual statements. I'm troubled, however, by certain aspects of the substantiation doctrine. Although I have not yet drawn strong conclusions about the doctrine, I do have several concerns that I intend to explore over the coming months.

First, the Commission may not have made sufficiently clear which claims need to be substantiated. Although the case law requires substantiation of all affirmative performance claims, the line between those claims that require substantiation and those that do not appear unclear to many advertisers. For example, a fruit juice vendor's plea for consumers to "try my product and see if you don't think it's the best" would probably not require substantiation today. But what about a claim that "people who try our product usually like it"? Although in most contexts the latter claim is not materially different in substance, it could be read to imply that the advertiser had supporting survey evidence. Uncertainty over how the Commission will exercise its discretion imposes costs on firms that advertise and on their ultimate consumers.

A second, and closely related, concern involves the Commission's determination of the meaning of claims. In the past there may have been too great a tendency to find implied claims that did not fit the common-sense meaning of the words. When an implied claim that the firm did not think it was making must be substantiated, problems arise, because the firm is not likely to have adequate substantiation for the implied claim. A tendency on the part of the Commission to impute claims that were never intended or were understood by only a small minority of consumers could lead to restrictions on useful information and thus harm to consumers in general.

Third, I am concerned about the quantum of substantiation required. The Commission has used a flexible approach in the past, but we need to assess those standards carefully. For example, if the reasonable basis requirement is too burdensome, consumers will pay more in increased costs than they receive by way of more accurate information. Also if objective claims require elaborate substantiation, while subjective claims do not, substantiation may reduce the overall informational value of advertising. That is, in their advertising, firms will tend

towards slogans and puffery, and away from hard information that may be more useful to consumers.

For these reasons I would like to consider whether there should be lower standards of evidence for reasonable basis than for claims once they have been challenged. And even in the extreme, I think we should reevaluate whether the Commission should impose any requirement for substantiation prior to the making of claims. I hasten to add, however, that even if the Commission were to revise its policy, this would not mean the end of ad substantiation. Indeed, for the reasons mentioned above - preservation of reputation, avoidance of lawsuits, and meeting industry self-regulatory standards - I would expect most firms to continue their substantiation programs, especially in view of effective Commission policy of prosecuting false and deceptive advertising.

Over the coming months, I will have much to say on this and other issues before the Commission. I want you to know, however, that in each case I will be guided by the statutes we are reponsible for administering and by my assessment of the evidence. Like most academics, I consider vital a willingness to question conventional wisdom. I promise you an open mind and a careful weighing of the facts.

Thank you very much.

# # #

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

ATTACHMENT 2

FALSE AND DECEPTIVE ADVERTISING: ASKING THE RIGHT QUESTIONS

REMARKS OF CHAIRMAN MILLER*

before the

AMERICAN ADVERTISING FEDERATION

Washington, D.C.

December 8, 1981

As you no doubt have heard, I have raised certain questions about the Commission's program of prior ad substantiation. To recapitulate, I do not take issue with the need to police false and deceptive advertising, or a requirement that advertisers suspected of making false and deceptive factual claims be required to substantiate those claims. What I do want to address is the Commission's use of the prior substantiation doctrine, including whether the Commission should find an advertiser guilty of a law violation for not having what the Commission considers acceptable prior substantiation even if, after a challenge, the advertiser is able to substantiate the claim.

To me, it's a little like having the Internal Revenue Code read that a taxpayer is guilty of tax evasion if he or she did not have the relevant "package" of receipts, notes, and other supporting evidence ready for inspection the moment the tax

* The views expressed are those of FTC Chairman James C. Miller III. They do not necessarily reflect the views of the Commission or other Commissioners.

return was filed, even though every figure could, in fact, be documented. Not only is this a question of fairness - just imagine voter reaction to such a proposal - it is also a matter of resource allocation. Some taxpayers know they stand a reasonably high probability of being audited or are risk averse. They tend to keep copious notes and prepare thorough "packages". Others prefer waiting to "get ready" to face the tax auditor should that become necessary.

I would contend that little is lost in terms of tax reporting accuracy by not having a legal requirement for "prior substantiation" in this area, and much is gained in terms of resource savings. And, even if one accepts the argument that without prior substantiation of ad claims there would be, for this reason, less incentive for advertisers to make truthful claims, that tendency could be overcome, it seems to me, by stricter enforcement against fraudulent and deceptive claims. At least the Commission should explore that possibility.

My discussion today goes not to the Commission's prior substantiation program, but to how we should allocate resources in carrying out our mandate to eliminate false and deceptive advertising. Specifically, it goes to asking the right questions.

One way the Commission might proceed in policing false and deceptive advertising is to examine each and every advertising claim, determine whether or not they are false or deceptive, and prosecute all offenders. Unfortunately, such a policy would require far more resources than the Commission has available or than taxpayers would find warranted. Obviously, some guidelines are needed, analogous to the guidelines the Commission and the Department of Justice are addressing in the area of mergers. My suggestion here is that the starting point for guidance be asking the right questions.

Commission Protocol on Deceptive Advertising

Back in 1975, the Commission adopted a protocol on deceptive advertising.[1] That protocol contained a series of questions for staff to answer in pursuing advertising cases. Although I reserve judgment on certain aspects of this approach, I feel that the protocol provides a workable framework for analysis and subsequent action.

The most relevant issue, of course, is what information the advertisement conveys. Almost all advertisements contain more than one message. Some are stated explicitly and emphasized, some are merely mentioned, and others can only be inferred from what the ad itself actually says. The protocol thus begins by asking the staff to list all messages contained in the ad and make an initial determination of which appear to be true and which appear to be false.

Of course, different recipients of an advertisement are likely to place different interpretations on it. It's not enough to know that an ad contains a claim, whether explicit or implied; it is necessary to know as well how many consumers actually get that message. Presumably most consumers who get anything at all from an ad will understand its main message. The more remote the claim is from the ad's main message, the smaller the number of consumers who are likely to receive it. Thus the protocol asks what proportion of consumers receive each of the possible messages thought to be conveyed by the advertisement. Since, as a matter of law enforcement priorities, it makes sense to scrutinize situations where large numbers of consumers are deceived before worrying about claims which may deceive only a few, it is also essential to ask how extensive is the challenged campaign.

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[1] A copy of the protocol is attached.

Even if everyone understands the ad to be making a claim that is indeed false or deceptive, there is not much public interest in proceeding against it if the claim does not influence purchase decisions. When a consumer who receives false information makes exactly the same choices as he or she would if the truth were known, the lie has not constituted injury, either to the consumer or to competitors. Indeed, lying will not pay under these circumstances. A false claim is only important if it causes consumers who believe it to purchase at the going price when they would not do so if they knew the truth.

The importance of a misrepresentation depends simultaneously on two factors: consumer response to the falsely advertised attribute, and on the price at which the product is offered. For example, we would expect that a claim that a car gets 40 miles a gallon when, in truth, it gets 35 would be important to more consumers than a claim that the car has 40 cubic feet of trunk space when, in truth, it has 35. This depends on a judgment that more car purchasers would find better mileage to be an essential reason to purchase the advertised car than would find greater trunk space to be an essential reason for purchase. Moreover, a misleading claim is more likely to harm consumers if the car sells for $6,000 than if it were to sell for $600.

Given that a false claim affects at least some purchase decisions, two additional questions are relevant: how many decisions are changed and by how much. The importance of the number of decisions that are affected should be obvious. We should care more about a claim which changes the decisions of everyone who receives it than a claim which only affects purchase decisions by a small number of consumers. Similarly, the magnitude of the effect on purchase decisions is also important. A false claim that a car gets 40 miles per gallon, for example, is worthy of far greater concern if the truth is that the car gets only 20 miles per gallon than if it in fact gets 39.

Of course, precise answers to these questions are very difficult to obtain. Nonetheless, it is important to ask the right questions. Approximate answers to the right questions are far more likely to produce wise public policy than precise answers to questions which are not very relevant.

The questions so far have assumed that if a false claim leads to consumer injury, there is no alternative to government action. In fact, market forces almost always provide some protection from false claims. Between two claims that compete for scarce law enforcement resources, the one against which corrective market forces are least effective should be the first challenged. Thus, a series of questions in the protocol is designed to elicit information necessary to assess the efficacy of normal market forces.

In general, market forces will be a more potent deterrent when it is easier for consumers to evaluate the product characteristics to which the claim relates. When consumers can easily evaluate the truthfulness of claims, there would seem to be little reason for government action. The possibility of consumers' easily evaluating claims not only deters false representations initially, it also limits consumer injury if false claims occur.

For example, some claims - such as the color of an automobile - can be easily evaluated by consumers prior to purchase. False claims about such attributes are altogether unlikely, precisely because the consumer is likely to discover the truth before he or she makes a purchase.

Other product attributes - such as the taste of soup in a can - cannot be evaluated prior to purchase, but can be easily determined by the consumer during normal use. When such a product is relatively low in price and is frequently purchased, consumers can determine by experience the truth of the advertised claim. In those cases, it makes little sense for an

advertiser to engage in deceptive advertising, and false claims will seldom lead to significant injury.

On the other hand, consumers can evaluate claims about some product attributes only if they acquire costly information. An example would be the effectiveness of an automobile air filter. Obviously, the ordinary consumer cannot evaluate the truthfulness of this claim very well by inspection, nor can he or she easily assess how well a particular brand of air filter protects the engine from dust particles through normal use alone. Experience with the car may be much the same whether the air filter does a good job or a poor job, at least until the engine begins to give real trouble. Even then, the trouble could be attributed to causes other than the ineffectiveness of the air filter. To determine the cause of the engine trouble will require outside information. False claims about such product attributes are least likely to be deterred by normal market forces and are most likely to lead to consumer injury, other things being equal.

Even when it may be difficult for consumers to evaluate a claim independently, other information sources may be readily available, such as the reputations of firms and published reports on product characteristics. When they are, the case for Commission action may be weaker since consumers can still protect themselves. Of course, this depends on the ease of access to the necessary information and how likely it is that consumers will verify the advertising claim by checking it against alternative information sources.

Appropriate Commission Action

With answers to the previous questions in hand, we can assess the benefits of Commission action. If a claim is to be considered a worthy candidate for challenge, the answers should have established that it is received by substantial numbers of

consumers, that it leads to significant injury, and that market forces are unlikely to remedy the problem. But even this may not be enough. Although Commission action in such a case may produce consumer benefits by improving the accuracy of one aspect of the advertisement, it may on balance make consumers worse off if it incidentally suppresses other truthful claims contained within the advertisement. It is thus necessary to ask about possible offsetting effects on the flow of truthful and useful information before Commission action would seem warranted. When such effects exist, it is of course necessary to evaluate the significance of the information suppressed, in the same way as one evaluates the benefits of eliminating a false or deceptive claim.

Incidental suppression of truthful information may occur in at least two ways. First, a claim that is barred for the sake of preventing deception to one group of consumers may have conveyed truthful and useful information to a different group. This result is particularly likely when the Commission challenges a false implication taken from an ad by a minority of consumers even though what the ad actually says to most consumers is correct. Consumers who do not make the false inference may be deprived of the useful information which the ad contains.

Second, useful information may be suppressed because of the standard of proof used to evaluate whether a claim is true or false. In addressing a particular claim, the Commission can make two different errors: it may incorrectly label a true claim as false, or it may equally erroneously label a false claim as true and allow it to continue. Either mistake imposes costs, although they are generally not the same. When the Commission incorrectly allows a false claim to continue, it loses the benefits that could have been obtained by prohibiting the claim. When it incorrectly prohibits truthful claims, it suppresses useful information.

In allocating enforcement resources, the standard of proof selected should consider both kinds of errors. Unfortunately, reducing the risk of one kind of error increases the risk of the other. To take a hypothetical, extreme example, the Commission could eliminate all false claims by simply prohibiting advertising altogether. In doing so, of course, it would simultaneously prohibit all truthful claims. At the other hypothetical extreme, it could avoid all risk of suppressing truthful claims by failing to take issue with any advertisements, no matter how patently false and deceptive. Obviously, neither extreme is appropriate. But the fact remains that we reduce the risk of allowing false claims only by increasing the risk of suppressing true ones.

This principle has long been understood by experts in criminal law, as well as by the framers of the U.S. Constitution. A court can make two kinds of errors in a criminal case: it can acquit a guilty defendant, or it can convict an innocent one. Generally, we concede that it is much more costly to society to convict the innocent than to acquit the guilty. Accordingly, we adjust the standard of proof in a way so that it is much harder to convict an innocent defendant than to acquit a guilty one. This is accomplished by requiring proof of guilt beyond a reasonable doubt. In civil cases, the costs of each kind of error are more nearly equal. The side with the preponderance of evidence prevails, a burden which is substantially easier to meet.

In evaluating which advertising cases to pursue, the appropriate standard for proving falsity depends on the claim involved. In some cases, the costs of incorrectly prohibiting true claims may be extremely high, while in others they may be quite low. Similarly the costs of erroneously allowing a false claim to continue will vary from case to case. The appropriate standard depends on the balance between the two. The greater the costs of incorrectly suppressing true claims, relative to

the costs of erroneously allowing false ones, the higher should be the standard for proving falsity.

To this point, our discussion of the protocol has envisioned the examination of particular advertising cases in isolation. Of course, each case is part of an ongoing law enforcement program. This program is intended not only to correct particular problems as they arise, but also to deter other violations of law.

Deterrence is an important public interest consideration. The incantation of this consideration, however, should not be used as a substitute for analysis, because all cases deter to some extent. In each case we should ask who will be deterred from doing what, and why the matter at hand possesses a particularly strong potential for deterrence.

Basically, the protocol considers deterrence in two ways. Even a well understood rule of law must be enforced if it is to be obeyed. Some proceedings may encourage obedience to a previously established rule better than others. Such potential for deterrence may justify a case if the circumstances suggest that the Commission's failure to proceed would encourage advertisers to flaunt the law.

The other way that deterrence may be used is quite different. If the law is unclear, the issue at hand may have an unusual potential for clarifying the law and for binding advertisers to the rule of law as newly clarified. If one seeks to justify a case by this kind of deterrence, it is important to ask exactly what clarification of the law is desired, and what practices would be affected by the newly clarified rule of law. The questions in the protocol solicit this information. When a case seeks to clarify the law, it is important to consider the benefits and costs of the clarification in other applications, as well as in the case at hand.

When an advertising case looks like a good one based on the criteria I have discussed so far, it becomes necessary to consider questions of overall law enforcement efficiency. Another agency may have taken action or may contemplate action. In some such cases, the Commission may wish to defer to them, or at the very least it should coordinate its actions with those of other agencies. It is also necessary to consider the difficulties of litigating a case and the Commission's expertise in resolving the issues involved.

Needless to say, it would be a rare event for a potential case to pass completely unscathed through all of the questions discussed above. But I do not think it necessary for the staff to have definitive answers to each question before recommending Commission action. In some instances, particularly when no formal investigation has occurred, some of the necessary information will not be available. In others, the responses to a few questions may be so telling that it will be clear that further efforts are, or are not, warranted. Still, for the reasons I outlined here, I think it is important the staff address these questions, and accordingly I have asked them to give this protocol much greater attention than in the past.

Conclusion

All of this may sound like a radical new approach to deceptive advertising cases. It is not. As I mentioned initially, the Commission adopted this series of questions back in 1975. I assure you that the protocol will receive renewed and increased emphasis under my administration. It is only by asking the right questions that we can hope to find appropriate answers. And it is only by basing our actions on these answers that our role in policing false and deceptive advertising can be accomplished efficiently.

Deceptive and Unsubstantiated Claims Policy Protocol

A. Consumer Interpretations of the Claim

1. List the main interpretations that consumers may place on the claim recommended for challenge, including those that might render the claim true/substantiated as well as those that might render the claim false/unsubstantiated.

2. Indicate which of these interpretations would be alleged to be implications of the claim for purposes of substantiation or litigation. For each interpretation so indicated, state the reasons, if any, for believing that the claim so interpreted would be false/unsubstantiated.

B. Scale of the Deception or Lack of Substantiation

3. What is known about the relative proportions of consumers adhering to each of the interpretations listed above in response to Question 1?

4. What was the approximate advertising budget for the claim during the past year or during any other period of time that would reflect the number of consumers actually exposed to the claim? Is there more direct information on the number of consumers exposed to the claim?

C. Materiality

5. If consumers do interpret the claim in the ways that would be alleged to be implications, what reasons are there for supposing that these interpretations would influence purchase decisions?

6. During the past year, approximately how many consumers purchased the product */ about which the claim was made?

7. Approximately what price did they pay?

8. Estimate, if possible, the proportion of consumers who would have purchased the product only at some price lower than they did pay, if at all, were they informed that the interpretations identified in response to Question 2 were false.

9. Estimate, if possible, what the advertised product would be worth to the consumers identified by Question 8 if they knew that the product did not have the positive (or unique) attributes suggested by the claim. If the claim can cause consumers to disregard some negative attribute, such as a risk to health and safety, to their possible physical or economic injury, so specify. If so, estimate, if possible, the annual number of such injuries attributable to the claim.

D. Adequacy of Corrective Market Forces

10. If the product to which the claim relates is a low-ticket item, can consumers ordinarily determine prior to purchase whether the claim, as interpreted, is true; or invest a small amount in purchase and then by experience with the product determine whether or not the claim is true? Does the claim relate to a credence quality, that is, a quality of the product that consumers ordinarily

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*/ Throughout, "product" refers to the particular brand advertise.

cannot evaluate during normal use of the product without acquiring costly information from some source other than their own evaluative faculties?

11. Is the product to which the claim relates one that a consumer would typically purchase frequently? Have product sales increased or decreased substantially since the claim was made?

12. Are there sources of information about the subject matter of the claim in addition to the claim itself? If so, are they likely to be recalled by consumers when they purchase or use the product? Are they likely to be used by consumers who are not aggressive, effective shoppers? If not, why not?

E. Effect on the Flow of Truthful Information

13. Will the standard of truth/substantiation that would be applied to the claim under the recommendation to initiate proceedings make it extremely difficult as a practical matter to make the type of claim? Is this result reasonable?

14. What are the consequences to consumers of an erroneous determination by the Commission that the claim is false/unsubstantiated? What are the consequences to consumers of an erroneous determination by the Commission that the claim is true/substantiated?

F. Deterrence

15. Is there a possibility of getting significant relief with broad product or claim coverage? What relief is possible? Why would it be significant?

16. Do the facts of the matter recommended present an opportunity to elaborate a rule of law that would be applicable to claims or advertisers other than those that would be directly challenged by the recommended action? If so, describe this rule of law as you would wish the advertising community to understand it. If this rule of law would be a significant precedent, explain why.

17. Does the claim violate a Guide or is it inconsistent with relevant principles embodied in a Guide?

18. Is the fact of a violation so evident to other industry members that, if we do not act, our credibility and deterrence might be adversely affected?

19. Is there any aspect of the advertisement -- e.g., the nature of the advertiser, the product, the theme, the volume of the advertising, the memorableness of the ad, the blatancy of the violation -- which indicates that an enforcement action would have substantial impact on the advertising community?

20. What, if anything, do we know about the role advertising plays (as against other promotional techniques and other sources of information) in the decision to purchase the product?

21. What is the aggregate dollar volume spent on advertising by the advertiser to be joined in the recommended action?

22. What is the aggregate volume of sales of the advertised product and of products the same type?

G. Law Enforcement Efficiency

23. Has another agency taken action or does another agency have expertise with respect to the claim or its subject matter? Are there reasons why the Commission should defer? What is the position of this other agency? If coordination is planned, what form would it take?

24. How difficult would it be to litigate a case challenging the claim? Would the theory of the proceeding recommended place the Commission in a position of resolving issues that are better left to other modes of resolution, for instance, debate among scientists? If so, explain. Is there a substantial possibility of whole or partial summary judgment?

25. Can the problem seen in the ad be handled by way of a rule? Are the violations widespread? Should they be handled by way of a rule?

H. Additional Considerations

26. What is the ratio of the advertiser's advertising expense to sales revenues? How, if at all, is this ratio relevant to the public interest in proceeding as recommended?

27. Does the claim specially affect a vulnerable group?

28. Does the advertising use deception or unfairness to offend important values or to exploit legitimate concerns of a substantial segment of the population, whether or not there is direct injury to person or pocketbook, e.g. minority hiring or environmental protection?

29. Are there additional considerations not elicited by previous questions that would affect the public interest in proceeding?

Senator SPECTER. Professor Yale Brozen, would you step forward, please?

We have your illuminating and excellently written submission, Dr. Brozen, entitled "A Perspective on Mergers," and subtitled "A Forthcoming Study From the American Enterprise Institute for Public Policy Research, Washington and London," a most impressive document.

The practice of the committee is to request that written statements be summarized, especially appropriate at this particular hour. But we do appreciate your coming from Chicago. We do express our regret at the lateness of the hour, but this is not atypical from the procedures which we find it necessary to pursue.

STATEMENT OF PROF. YALE BROZEN, UNIVERSITY OF CHICAGO, CHICAGO, ILL.

Mr. BROZEN. Thank you, Mr. Chairman. I appreciate the opportunity to appear, and I apologize for the fact that I was unable to prepare a summary. It was only a few days ago that I was called. It was fortunate that I had work in progress at the time, so that I could at least submit that portion of the work that was completed, although a portion of that is missing. I will have to submit the footnotes next week, since they are in the process of being typed at this time.

Senator SPECTER. Your statement will be made a part of the record, Dr. Brozen.

Mr. BROZEN. Thank you.

I was asked to talk primarily in terms of U.S. merger policy. One expression of that policy, today at least, appears in the form of the merger guidelines that were issued in 1968 by the Department of Justice. The guidelines were characterized in 1969 by the Presidential Task Force on Competition and Productivity as being far too stringent and in many respects indefensible. I agree with that conclusion.

Also, the courts have demonstrated that the purely statistical indexes, as used in the merger guidelines, is not a proper reading of the antitrust laws which prohibit anticompetitive mergers. That literal application of the merger guidelines suppresses some procompetitive mergers was demonstrated in the recent attack by the Department of Justice on the proposed merger of Schlitz and Heileman.

When it became known that the Department would attempt to prohibit the Schlitz-Heileman merger, Anheuser-Busch stock made a new high for the year. Its stockholders obviously felt that the merger would result in a more competitive market, which would make the prospective earnings of Anheuser less secure.

The Antitrust Division should not have attacked that merger. Its doing so restrained competition and the growth of trade in the judgment of investors and analysts who must carefully evaluate the probable consequences of public policy in making their investment decisions. They regarded the Department's action as a restraint on trade which made life less competitive for Anheuser-Busch.

The Antitrust Division followed a very strict antimerger policy with respect to, among others, the brewing industry in the 1950's and 1960's. The result of that policy was the waste of a large amount of capital.

Growing companies that needed additional capacity were prevented from acquiring breweries and brewing capacity. Instead, they had to build new capacity. The result was that the industry reached a point where it had 40 percent excess capacity. Small brewers, who could have sold out on reasonable terms but for the strict antimerger policy of the Justice Department, instead were forced to shut down, and their capital facilities were idled or junked.

In a time of capital shortage, that caused a great waste. It limited the growth in productivity that would have occurred if we had made better use of our capital. And it did not prevent the growth of concentration in the beer industry.

The Federal Trade Commission staff concluded, in a 1979 study, that the brewing industry is more concentrated today than it would have been if the Justice Department had not applied such strict antimerger policies.

The United States has the world's most stringent antimerger laws. While the policy in most other countries aims at encouraging mergers or is neutral, that in the United States is manifestly hostile to this activity.

The chief difference in the design of domestic and foreign merger policy is the lively sense displayed abroad of the economic gains that size confers. Europe's post-World War II economic policy, for example, is deliberately aimed at producing an economic structure comparable to that of the United States.

The Economist, for instance, Britain's prestigious economic weekly, writes that, The EEC's industry policy is to encourage size. The policies followed in individual countries are consistent with this approach. Particularly in France but to varying degrees in other countries as well, mergers have been encouraged or tolerated as a way of setting the units of the national economy on a level equal to that of competitor nations. The active concern of policymakers in Europe is not the prevalence of industrial concentration but, rather, the handicap of inefficient, undersized industrial units.

Professor Scherer, who is a former head of the Bureau of Economics at the Federal Trade Commission, noting attitudes in other countries remarks that:

> Those who read extensively in both the American and European industrial organization literature cannot avoid being struck by the contrast in emphasis. American economists seldom get very excited about scale economies, while for the typical European industry analyst the day begins and ends with an impassioned tract on the advantages of size.

The merger policies of America's competitor nations reflect that attitude. They allow, and often promote, the growth of their firms to the size of the largest U.S. firms.

If you will look at table 1, which is in the manuscript and also is in a separate set of tables that I have provided, you will see that the larger-sized foreign industrial companies have been growing in size relative to U.S. industrial companies. Measuring the top 100 U.S. industrials against the top 100 foreign industrials, in 1965 the 100 largest foreign industrial companies had 63 percent of the assets of the U.S. 100 largest industrial companies. The average company among the 100 largest foreign companies in 1980 had 117 percent of the average U.S. industrial among our largest 100.

If you look simply at the list of the world's leading 50 industrial companies, in 1967 12 of them were foreign. Today 27 are. Foreign firms in the top 50 have more than doubled in number in the past decade. The increased representation of European and Japanese chemical, electrical, and automobile firms is particularly noteworthy.

There are many industries in which U.S. firms are losing ground to their foreign competitors. In banking, for example, six of the eight leading banks in the world were in 1960 U.S. firms. Now only two of the eight leading banks are domiciled in the United States. In metal manufacturing, seven of the eight leading firms in the world were based in the United States in 1960. Now only three out of eight are.

Some of that change is due to economic factors that are independent of national concentration policies, but it should be noted that new firms created through mergers have taken some of the top positions. Nippon Steel, which is the largest steel company in the world, was a merger of Japan's number one and number two steel firms. Peugeot-Citroen, which is now the third largest automobile company in the world, is a merger of two French companies

plus the acquisition of Chrysler assets in Europe. Elf-Acquitaine, one of the world's leading oil companies, is a merger of several French oil companies. Similar mergers in the United States are prohibited.

The somewhat more favorable attitude abroad toward mergers and increases in firm size augments other factors that work to the benefit of many overseas firms. That does not provide a justification for adopting wholesale the industrial policies of overseas competitor nations. Many influences besides government policies govern the changes in size and commercial success of firms. It should also be cautioned, too, that the policies that promote size abroad often do so at the expense of efficiency and by converting what ought to be economic decisions into political ones.

Subsidization and nationalization of firms have had unhappy consequences in some instances. Current difficulties of the British Steel Corp. are illustrative.

It can be argued, however, that a good deal of the more productive aspects of European and Japanese policies are aimed at remedying the inefficiencies of economic fragmentation, and that appears to be sound policy, just as it would be sound policy for the United States to remove some of the internal restrictions that we have and pursue an essentially neutral policy toward both aggregate and market concentration.

The study which I have provided to the committee suggests the case for neutrality in U.S. merger policy. It describes the changing size and character of successive merger movements in the United States and their impact on industrial and aggregate concentration.

Horizontal mergers, which were common before the enactment in 1950 of the Celler-Kefauver Amendment to the Clayton Act, show no detectable long-run effect on industrial concentration, and that includes the truly gargantuan amount of merger activity around 1900 when 53 percent of manufacturing assets were involved in the consolidations between 1898 and 1902.

I have provided some tables that are suggestive in terms of what happened in those circumstances. In table 5, page 19 of the manuscript, we can see the fate of some of the successful consolidations which were efficient consolidations. Standard Oil, which had 88 percent of the market in 1899, lost 21 percentage points of its market position by 1909. Then there was antitrust action which broke up the company in 1911.

American Sugar Refining, which combined 95 percent of the refining capacity in the United States in 1892, had dropped by 20 percentage points in its market share by 1894, and it dropped by another 26 percentage points by 1907 and nearly another 19 percentage points by 1917.

Senator SPECTER. Dr. Brozen, may I interrupt? At what point, if any, would you prohibit mergers?

Mr. BROZEN. I would suggest, being cautious, that if a market share of more than 50 percent is created by a horizontal merger, that should be looked at extremely carefully. However, there is some evidence that even larger market shares have not had an anticompetitive impact.

Senator SPECTER. Should be looked at carefully?

Mr. BROZEN. Should be looked at carefully.

Senator SPECTER. A presumption of anticompetitiveness?

Mr. BROZEN. A possibility of anticompetitiveness. I would not go strictly by statistical indices.

Senator SPECTER. You have made that point—that you would not—but beyond 50 percent you would take a look?

Mr. BROZEN. I would take a very careful look.

Senator SPECTER. At what point would you stop the merger, if at all?

Mr. BROZEN. In the case of American Sugar Refining, for instance, they had 98 percent of the capacity east of the Rockies. They managed to raise the price of sugar by 5 percent in the next year. That was part of the reason they so rapidly lost market share then, because entry occurred.

Senator SPECTER. Are you suggesting that 98 percent of the market east of the Rockies would be prohibited for a merger?

Mr. BROZEN. I would suggest so.

Senator SPECTER. You would not look for any more than 98 percent?

Mr. BROZEN. No.

Senator SPECTER. How much less than 98 percent would you look for?

Mr. BROZEN. Referring to the experience in American Sugar Refining, they lost all their ability to have any control of the price of sugar by 1894, when they dropped to 75 percent.

Senator SPECTER. So the substantial lessening of competition works itself out?

Mr. BROZEN. Yes.

Senator SPECTER. Notwithstanding its working itself out, you would not let it get to the point of American Sugar?

Mr. BROZEN. There were some penalties to consumers in 1892 and 1893 as a consequence of their 98 percent share of the market. By the time they dropped to 75 percent, they lost all power to impose any price increases.

Senator SPECTER. What guidelines would you suggest to the committee between 50 percent, where you take a close look, and 98 percent, where it is too much?

Mr. BROZEN. American Sugar Refining suggests that 75 percent is no longer enough to have any price impact on the market. American Can had a similar sort of experience. By the time they dropped down to 60 percent, they lost all control and ability to produce any anticompetitive impact.

Those two experiences certainly suggest that it takes at least 60 percent in the can industry and at least 75 percent in the sugar industry in the hands of a single firm to have any anticompetitive impact on the market.

In the case of United Shoe Machinery, they had something on the order of 90 percent of the market for shoe machinery—a little less than that; 88 percent—on the average.

Let me point out to you that American Sugar and American Can are unusual cases among these consolidations that occurred around the turn of the century. The average experience is that consolidations brought efficiencies and reduced prices. That is shown in figure 1 on page 20, where, taking those industries where there

were major consolidations, from 1900 to 1914, prices dropped in those industries by 15 percent. That is the A line in that figure.

On the other hand, taking the C line, which shows the industries in which no major consolidations occurred, you will see that, using that as a control, prices rose in those industries from 1900 to 1915 by about 10 percent.

In contrast with the average experience of industries with no consolidations, the industries in which consolidations occurred, on the average, had about a 25-percent price drop relatively.

Taking it up through the postwar experience, through 1925, you will see that in the industries which had major consolidations in them, relative to 1900, prices rose by 28 percent. For those which had no major consolidations in them, prices rose 117 percent.

In other words, the industries which had major consolidations evidently produced sufficient efficiencies so that their prices, during that inflationary period in World War I, rose considerably less than the industries in which there were no major consolidations. That is the average experience, including the unusual ones, like American Sugar Refining and American Can, which attempted to raise prices.

Averaging all that experience together, the net result was that the industries in which major consolidations occurred had falling prices in the prewar period, while industries with no major consolidations had rising prices. There is a strong contrast then as to what happened to prices during the inflationary period of World War I. Their prices rose much less than those with no major consolidations.

Conglomerate mergers, the predominant type of acquisition since the 1950's, show no influence on aggregate concentration and no negative influence on the number of businesses in operation. If anything, they had a positive influence.

Senator SPECTER. The question has been raised, Professor Brozen, about having questions submitted to you by Senator Metzenbaum. Would you be willing to respond to written questions?

Mr. BROZEN. Surely.

Senator SPECTER. Thank you very much. You may proceed.

Mr. BROZEN. Table 10 on page 62 shows what has happened to the number of firms during the period of the conglomerate merger wave of the 1960's. You will see the total number of active corporations increased by more than 40 percent from 1960 to 1970. It increased from 1,141,000 corporations to 1,665,000 corporations.

I would suggest that that may in part have been the positive influence of conglomerate mergers, because conglomerate mergers, in effect, increased the demand for firms. If you increase the demand for anything, there will be a supply response. The number of firms will tend to increase.

Senator SPECTER. Professor Brozen, I am going to have to ask you to summarize in the course of the next 5 minutes or so, because there is another vote on, and I think it is not going to be practical to return to continue the hearing at that point.

Mr. BROZEN. Surely.

I have also offered some evidence on what conglomerate mergers do to efficiency. To just quickly take a look at that—this is from Census data prepared by the Bureau of the Census—let us refer to

table 8 on page 31 of the overall statement. The bottom line of that table shows that conglomerate firms in 1954 were 22 percent more productive than single-line firms. In 1963 they were 30 percent more productive in terms of value added per worker. In 1972 they were 17 percent more productive.

In part, the conglomerate merger wave of the 1960's, I would suggest, is a response to whatever it was that raised the productivity of workers in conglomerates to 30 percent above the average for workers in nonconglomerate firms. Evidently there was something that worked there that made it possible for conglomerates to be more efficient than single-line firms.

In general, let me say that when we get waves of strong merger activity, that is a manifestation of the competitiveness of the economy. It is an adaptation to changing circumstances which is occurring.

There have been studies done looking across countries to see in what sort of industries we get strong merger waves from time to time. Looking at France for example, when the European Economic Community was formed and tariff barriers were reduced, in those industries in France where there was a 12-percent loss of business to foreign competition, there was strong merger activity. They were simply adapting to the increasing competition that occurred as a result of the EEC change in circumstances.

In those industries where there was a 15-percent rise in the exports of the industries, there were very few mergers. So it was the competition of foreign companies with French companies that resulted in strong merger activity in some of those French companies.

In general, I think we can find, if we just track the data a bit better, it has been attempted on cross-country comparisons for Germany, for France, for England, and for the United States, and it seems that the merger activities are a competitive response to changing technological circumstances, changing market circumstances, and changing institutional circumstances.

I think, in part, maybe what might have done this in the 1960's and 1970's to create the conglomerate merger wave was the greater amount of regulation that was brought into focus in the United States at that time, the greater costs of dealing with Government with regulation, and the economies of size that come from a larger firm to deal with those regulations.

If you look at legal costs, for example, per $1 million of sales, in small firms that may run on the order of $2,000 or $3,000 per $1 million of sales. In large firms, that may run on the order of $400 or $500 per $1 million of sales. There is a table somewhere in that manuscript which lays out those data showing legal costs per $1 million of sales by size of firm.

I think you will find the same sort of thing occurring, for example, in the case of accounting costs—that they will drop per $1 million of sales as the size rises. There are other factors of that kind at work where the economies of size are not product-specific, where the economies of size come from other things than product-specific economies that we usually think of as economies of scale. That may have had a good deal to do with the conglomerate merger wave.

By conglomeration, we bring those economies of size to small market share firms in industries where they might not otherwise be able to survive. By this means, we maintain a lower level of concentration in those industries than would occur absent the economies of size brought by conglomerate merger.

I would suggest, in conclusion, that the 1968 guidelines are themselves based on disproved assumptions concerning structural characteristics of the economy and their consequences. They do not fit a world in which markets are international, with competition as common across national boundaries as it is within national boundaries, and they are in strong need of revision.

Senator SPECTER. Thank you very much, Professor Brozen. We very much appreciate your coming. We appreciate the submission of your statement.

As you have stated, there are additional materials you will be submitting with footnotes. We only received this yesterday, as I understand it, and it will be circulated among members of the committee.

In addition to the questions which Senator Metzenbaum wishes to submit, there may be others submitted to you, if you would be willing to respond in writing to them.

Mr. BROZEN. Certainly.

Senator SPECTER. We are sorry to have kept you so long. The procedures in the Senate require that the votes come first, and there is a very short time for the next vote, so I think this is an appropriate time to adjourn, with our thanks.

Mr. BROZEN. Thank you, Senator.

[Whereupon, at 5:10 p.m., the hearing was recessed, subject to the call of the Chair.]

[Questions to Yale Brozen with responses were subsequently supplied for the record, along with a study from the American Enterprise Institute for Public Policy Research.]

QUESTIONS FOR YALE BROZEN

1. Comparing the relative sizes of the three historical merger waves, you note that the 1898-1902 merger values in manufacturing and mining amounted to $6.3 billion, the amount in 1926-1930 was $7.3 billion and in the 1966-1970 period was $46 billion. Can you give us an idea of what those figures might look like in today's dollars and how they would compare with the merger level we are witnessing today?

2. I understand your position as being that horizontal mergers should raise little concern since history shows that a dominant company's market share dwindles if it is not efficient, and that the consumer is served by its persistence where it is efficient. This view, however raises several questions:

a. Is it possible to determine how much of the historical shifting in concentration levels is due to the natural force of competition and how much might be due to active enforcement of the antitrust laws?

b. Isn't is possible that some of the firms that have persisted have done so not because of their productive efficiency, but rather because of their efficiency in suppressing competition?

c. Do you completely discount the argument that high levels of horizontal concentration can facilitate collusion and price-fixing?

d. Isn't it possible that the consumer can be significantly harmed during the period of time it would take competition to break down a collusive relationship, and isn't that reason enough to be concerned about horizontal mergers?

(ANSWERED AT HEARING)

3. In light of your criticism of the Justice Department's merger guidelines, can you suggest any level of guidelines that you would think appropriate?

4. Do you believe that a seller which possesses substantial power as a buyer could ever successfully use that power to improve its market position as a buyer through a reciprocal arrangement, and if so, should this be a matter of antitrust concern?

5. If reciprocal arrangements can be used to secretly undermine collusion by cutting prices invisibly, can't they also be used to discriminate between customers in violation of the Robinson-Patman Act, and does this raise any concerns for you?

6. Some critics of the recent merger trend argue that large acquisitions tie up credit lines, often for months at a time, to the detriment of smaller businesses which would otherwise have this credit available for capital investment. Would you comment on this?

7. With respect to the proposed Mobil/Marathon merger, the independent gasoline marketers point out that Mobil has traditionally not supplied to them, while Marathon has been one of their primary suppliers. If Mobil were to continues its past practice after acquiring Marathon, and Mobil has not indicated to the contrary, the independents argue that they will be forced out of business for lack of supply. This would have the result of eliminating the most vigorous price competition from the retail market in which Mobil competes. How would you respond to this argument?

8. If a generous merger policy encourages entry by entrepeneurs as you argue, why do you suppose that small business organizations are so hostile to relaxing merger standards?

Answers

1. The $6.3 billion book value of mergers in the 1898-1902 would be 80 billion in today's dollars using the 1981 third quarter GNP implicit price deflator. The 1926-30 total of 7.3 billion would be 44 billion in current dollars, again adjusting by the GNP implicit price deflator. The 1966-1970 total of $46 billion would be 108 billion in today's dollars. The most recent comparable figure that I have is for 1979 when the book value of manufacturing and mining corporation assets acquired amounted to 16 billion, which equals 19 billion in 1981 dollars. If that level continued to prevail for five years, say 1979-1983, the total would be $85 billion.

2a. Studies by Joe S. Bain, Peter Pashigian, and F. L Pryor have compared industry concentration ratios in the U.S., where antitrust regulation has aimed at restricting market concentration, to the industrial concentration ratios of highly industrialized nations in Europe, where restrictions on firm combinations have been non-existent. Pryor concludes that ". . . the data show that the average 4-digit concentration ratios among large industrial nations are roughly the same . . . ." Pashigian, in his comparison of industrial concentration in the U.S. and Great Britain concludes that, adjusting for market size, there is no significant difference between the levels of concentration in the U.S. and those of Great Britain.

These studies strongly suggest that market concentration in the U.S. has been unaffected by active antitrust policy. Rather, fundamental technological and economic forces play primary roles in the determination of market structure.

[References: J. S. Bain, International Differences in Industrial Structure (New Haven: Yale Press) 1966.

F. L. Pryor, "An International Comparison of Concentration Ratios, Review of Economics & Statistics, vol. 54.]

A report by the FTC's Bureau of Economics indicates that antimerger policies may have, in fact, promoted higher concentration in at least one industry. The report states:

[antimerger policy may have] promoted higher national concentration in two ways:

(1) by foreclosing the merger route to the national brewers, it forced them to expand internally. As we have seen, their large new breweries are more efficient than the older ones, . . .

(2) The Department has blocked merger of smaller brewers. This may have had the effect of weakening the competitive position of the latter group of firms.

[Source: FTC, Bureau of Economics, The Brewing Industry (Washington, D.C., U.S. Government Printing Office, 1979) pp. 64-65.]

2b. Suppressing competition is a very costly means of operation. Firms that pursue policies of predatory pricing or that engage in the acquisition of potential competitors soon discover that rather than enhancing profitability, anti-competitive behavior drains resources and in fact, reduces profitability.

The National Biscuit Company provides an interesting case of a firm that attempted to control its competition. The 1901 annual report states:

> In the past, the managers of large industrial corporations have thought it necessary, for success, to control or limit competition. So, when this company started, it was believed that we must control competition, and that to do this we must either fight competition or buy it. The first meant a ruinous war of prices and great loss of profits; the second, constantly increasing capitalization. Experience soon proved to us that, instead of bringing success, either of these courses, if persevered in, must bring disaster. This led us to reflect whether it was necessary to control competition . . . We soon satisfied ourselves that within the company itself we must look for success.
>
> We turned our attention and bent our energies to improving the internal management of our own business to

> getting the full benefit from purchasing our raw materials in large quantities, to economizing the expense of manufacture, to systematizing and rendering more effective our selling department, and above all things and before all things, to improving the quality of our goods and the condition in which they should reach the consumer . . .

2c. No. In the short run high levels of concentration may permit a firm to raise prices above the otherwise competitive level. These prices, however, cannot be sustained. As Professor Richard Posner has stated

> to do so [raise prices above costs] invites entry, which soon invites the decline of the market shares of the colluding companies.

The cases of American Sugar Refining Company and American Can Company are illustrative. At the end of 1891 American Sugar held 98 percent of the refining industry's capacity east of the Rockies. In 1892 and 1893 it attempted to raise prices 5 percent. By 1894, it had lost one-fifth of its market to new entrants. Prices returned to 1891 levels.

The case of American Can Company is similar. Holding 90 percent of the market in 1901, American Can Company raised its prices above cost. By 1903 prices had returned to competitive levels and American Can's market share had dwindled to 60 percent.

2d. Yes. Consumers of American Sugar Refining's products, for example, paid 5 percent more than they would have otherwise paid during the period of time it took the market to adjust. For this reason I would examine carefully mergers encompassing over 60 percent of the market to determine whether or not they should be permitted. If competing firms have significant excess capacity, or if the entry of new firms into the industry is unconstrained, then any attempts to raise prices on the part of the leading firm will be met by competition from lower price sellers. Prices will be driven back to competitive levels and the leading firm will suffer an erosion of its market position.

The inability of a large firm to influence prices in its own industry

is illustrated by the 1927 shutdown of the Ford Motor Company. Ford was the dominant auto manufacturer in the 1920s, producing as many cars as all other companies combined. Yet, when Ford ceased all production for nearly a year, prices in the automobile industry failed to rise. Other manufacturers were able to increase their output sufficiently so that by mid 1927, the price of new cars had actually fallen.

4. In general, reciprocity agreements are simply a means of competitive price cutting. They were most extensively used by railroads who were barred from price competition by the rate floors set by the The Interstate Commerce Commission. With price competition restricted, railroads resorted to offering to buy supplies from potential shippers in return for the shippers' use of their freight services. The effect is analogous to competition along any other of a number of non-price mechanisms commonly used by sellers to attract buyers, i.e. offers of credit, quick delivery, etc.

5. The Robinson-Patman Act is aimed at preventing discrimination among retailers. By their very nature, there is little retailers have to offer wholesalers (in terms of supplies or services) that would make for an advantageous reciprocal agreement. Thus, the levels of distribution which the Robinson-Patman Act seeks to protect are not endangered.

6. First, bankers faced with an uncertain use of lines of credit tend to over extend credit lines to commercial borrowers. Additionally, even large mergers require an amount of financing that is small relative to the size of the commercial credit market at any given time. Potential acquisitions should not reduce the availability of credit to worthy commercial borrowers.

7. The refining industry is presently operating at less than 70 percent of capacity. Profitable operations usually require that approximately 90 percent of capacity be in use. If Mobil were to refuse to sell to independent gasoline marketers there is a large number of other refiners, all with sufficient capacity, who are ready, willing and able to pick up the sales.

8. A small firm that is acquired by a larger concern is frequently able to take advantage of operating efficiencies, not previously attainable due to its small size. These may be economies in production of goods and services where the merger is among firms in the same line of business, or the economies may be in terms of improved access to financial markets, marketing and distribution economies or managerial efficiencies in cases of conglomerate mergers. Small business organizations will resist the acquisitions when they fear that conglomeration will result in the emergence of new, lower-cost competitors.

Where small business organizations are made up of the managers of small businesses, rather than the owners, oppositon to mergers can reflect a split between management and ownership interests. Since acquiring firms must pay existing owners an amount greater than the present value of the future earnings, expected under the present ownership, a firm's stockholders stand to benefit from its acquisition. The same is not true for the acquired firms managers, who face considerable uncertainty as to their future in the new company. We could expect, then, that small business organizations comprised of managers would resist mergers on job security grounds.

A PERSPECTIVE ON MERGERS

Yale Brozen

A forthcoming study from the
American Enterprise Institute for Public Policy Research
Washington and London

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Chapter 1

Introduction

The United States has the world's most stringent merger laws. While policy in most other countries aims at encouraging mergers or is neutral, that in the United States is manifestly hostile to this activity.[1]

The chief difference in the design of domestic and foreign merger policy is the lively sense displayed abroad of the economic gains that size confers. Europe's post-World-War-II economic policies, for example, deliberately aim at producing an economic structure comparable to that of the United States. In particular, the European Economic Community (EEC) was intended to provide a market large enough to support firms as big as those in the United States. "The EEC's industrial policy is to encourage size," writes The Economist, Britain's prestigious weekly.[2] The policies followed in individual countries are consistent with this approach.[3]

Particularly in France,[4] but to varying degrees in other countries as well, mergers are encouraged or tolerated as a way of setting the units of the national economy on a level equal to that of competitor nations. The active concern of policy makers in Europe is not the prevalence of industrial concentration but rather the handicap of inefficient, undersized industrial units. Professor F. M. Scherer, noting attitudes in other countries, remarks that

> Those who read extensively in both the American and European industrial organization literature cannot avoid being struck by the contrast in emphasis. American economists seldom get very excited about scale economies, while for the typical European industry analyst, the day begins and ends with an impassioned tract on the advantages of size.[5]

The Growth in Relative Size of Foreign Competitors

The concentration policies of America's competitor nations allow, and often promote, the growth of their firms to the size of the larger U.S. firms (see table 1). European and Japanese corporations are now approaching, and in some cases have surpassed, their American rivals in size (and

in their capacity for innovation). In 1967, twelve of the world's leading fifty industrial firms were foreign; today twenty-seven are. Foreign firms in the top fifty more than doubled in number in the past decade. The increased representation of European and Japanese chemical, electrical, and automobile firms is particularly noteworthy.

In diverse industries, U.S. firms are losing ground to their foreign competitors. In banking, for example, six of the eight leading banks of the world were, in 1960, U.S. firms. Now only two of the eight leading banks are domiciled in the United States. In metal manufacturing, seven of eight leading firms were based in the United States in 1960. Now only three are. While some of this change is due to economic factors that are independent of national concentration policies, it should be noted that new firms created through mergers have taken some of the top positions (Nippon Steel, Peugeot-Citroen, and Elf Aquitaine). Similar mergers in the United States are prohibited.

The somewhat more favorable attitude abroad toward mergers and increases in firm size augments the factors that work to the benefit of many overseas firms. This does not, to be sure, provide a justification for adopting

Table 1

Size of 100 Leading Foreign Industrial Firms Relative to
100 Leading U.S. Industrial Firms
by Groups, 1965, 1977, 1980

Firm Group (by rank)	1965			
	Ratio of Foreign Firms' to U.S. Firms' Sales by Rank		Foreign Firms' Total Assets Ratio to U.S. Firms' Total Assets	
	Ratio ($ billion)	Percentage	Ratio ($ billion)	Percentage
1-10	29/75	38	34/65	51
11-25	18/36	49	14/33	43
26-50	22/37	59	26/29	90
51-100	30/44	68	33/41	82
1-100	99/192	52	107/169	63
	1977			
1-10	164/298	55	139/193	72
11-25	131/130	101	123/119	104
26-50	131/129	102	118/84	140
51-100	163/159	103	194/123	158
1-100	589/716	82	574/519	111
	1980			
1-10	300/452	66	248/281	88
11-25	232/215	108	196/169	116
26-50	224/206	109	211/149	142
51-100	261/241	108	239/166	144
1-100	1017/1114	91	895/765	117

Source: Fortune, May-August 1966, 1978, and 1981.

wholesale the industrial policies of overseas competitor nations. Many influences besides government policies govern the changes in the size and commercial success of firms. It should also be cautioned that the policies that promote size abroad often do so at the expense of efficiency and by converting what ought to be economic decisions into political ones. Subsidization and nationalization of firms have had unhappy consequences. The current difficulties of the British Steel Corporation are illustrative. It can be argued, however, that a good deal of the more productive aspects of European policy are aimed at remedying the economic fragmentation of Europe. This appears to be sound policy, just as it would be sound policy for the United States to remove internal restrictions (such as those on branch banking at the state level and across state lines) and pursue an essentially neutral policy toward both aggregate and market concentration.

The Conclusions of this Study

The following pages suggest the case for neutrality in U.S. merger policy. The changing size and character of successive merger movements in the United States are described. Their impact on industrial and aggregate concentration is analyzed. Horizontal mergers, which were common before the enactment in 1950 of the Celler-Kefauver Amendment to the Clayton Act, show no detectable effect on industrial concentration. Conglomerate mergers, the predominant type of acquisition since the 1950s, show no influence on aggregate concentration and no negative influence on the number of businesses in operation. If anything, they had a positive influence. They may also have brought the economies of size to firms small in their industries with the result that industries in which conglomerates operate are less concentrated than they would have been if conglomerates had not been allowed to enter via merger.

Also, we analyze the influence of conglomerate mergers on efficiency and the influence of corporate size on the ability to exercise economic and political power. Although some argue that conglomerate marriages among firms have no redeeming social value and simply reflect the megalomania of corporate empire builders, the data contradict this view of merger motivation.[6/] The few analyses of political power that have been performed fail to demonstrate any ability by large corporations to exert great political influence.

The conclusion that follows from the analysis is that the merger guidelines issued by the Department of Justice in 1968 are misguided.[7] They are in need of revision, both to accord with economic reality and to take into account what the courts allow.[8] They assume that market concentration is an index of the probability of tacit collusion, but its usefulness for that purpose is much doubted.[9] They are based on disproved assumptions concerning the causes and effects of industrial concentration.[10] They do not fit a world in which markets are international with competition as common across national boundaries as it is within national boundaries.

Chapter 2

Mergers in Perspective

Corporate merger activity made its splashiest headlines of at least a decade during the bidding war for Conoco, the nation's ninth largest oil company, and for Marathon, the nation's seventeenth largest oil company. Although the amount paid by du Pont for the shares it acquired set a new record for the size of its bid, $7.3 billion, that record was as much the result of inflation as it was of the size of the acquisition. The du Pont bid appears less awesome when we measure it and previous mergers in constant dollars. The all-time record measured in constant dollars was set as long ago as 1901, when U.S. Steel exchanged $12 billion in securities, in today's dollars, for the companies it consolidated.

Merger Waves and Their Size

Historians have recorded three distinct merger waves. A late nineteenth century wave crested in the five years 1898-1902, when recorded merger values in manufacturing and mining amounted to $6.3 billion.[1] Carl Eis found that assets of companies acquired in the five years 1926-30, the crest of the 1920s merger wave, amounted to $7.3 billion.[2] The Federal Trade Commission (FTC) reported that the total assets of large manufacturing and mining acquisitions (firms with assets of $10 million dollars or more) amounted to $46 billion in the 1966-70 period, the crest of the 1960s merger wave.[3] And we seem now to be in the midst of a fourth merger wave. FTC Acting Chairman David Clanton testified before a House Subcom-

mittee that the amount paid in all merger transactions in the first half of 1981, before the occurrence of the contest among du Pont, Mobil, and Seagram for Conoco, was $35.7 billion. He compared this with the total amount paid in the full year 1975 of $11.8 billion.[4/]

Because of the declining value of the dollar and the growth in the size of the economy, these increasingly large nominal values in the successive merger waves exaggerate the relative size of the later transactions. Although the U.S. Steel consolidation is measured at 12 billion of today's dollars, the securities it issued at the time amounted to only $1.36 billion. The total book value of $6.3 billion for the manufacturing and mining assets acquired in the 1898-1902 mergers would be $57 billion in today's dollar (and the value of the securities exchanged for these assets would be even greater).

To gain an appropriate perspective, we should measure the size of each episode relative to the size of the manufacturing and mining sector. The turn-of-the-century consolidations in the five years 1898-1902 added up to 53 percent of the book value of all manufacturing and mining corporations. The recorded acquisitions of the late 1920s measured 9 percent of all corporate manufacturing and mining assets. The medium and large acquisitions of the latter 1960s came to 7.6 percent of such assets.

Simply looking at either the total nominal value of manufacturing and mining assets changing hands or the percentage of all such assets, however, tends to overstate the actual magnitude of control over assets attained by acquiring firms. There is double counting involved in simply adding together the value of every acquisition in a five-year interval. An acquisition by one firm is often either a part of a later acquisition by another or a later divestiture by that firm. U.S. Steel, for example, was a 1901 consolidation of ten consolidations. Assets merged in nine earlier consolidations in the steel industry in the years 1898-1900 were counted again in the U.S. Steel combination for the 1898-1902 total.

Frequently, parts of an acquisition are divested by the acquiring firm. Since the acquisition of a divestiture is incorporated into the total count of acquired assets, this too results in double counting. In 1967, divestitures accounted for 11 percent of all mergers and ac-

quisitions by number. They mounted to 39 percent in 1973, and then to 54 percent in 1975. Although they then began a decline to 45 percent in 1977, they still amounted to 35 percent in 1979.[5/]

The result of adding all assets in all mergers in any period covering five years, as we did in each of the instances described above, is to count some assets two or three times if the same assets are involved in two or three successive mergers. In the primary metal industry, for example, Ralph Nelson found that the sum of assets in all mergers from 1895 to 1907 in that industry amounted to 210 percent of the industry's assets,[6/] an obvious case of double and triple counting.

A comparison of the proportion of all manufacturing assets in the hands of consolidations at a given point in time with the sum of all mergers in a preceding period as a proportion of all assets yields another indication of the double counting involved in adding together each and every merger in a given time span. Walter Adams reports that the 300 industrial combinations in existence in 1904 "controlled fully 40 percent of the nation's manufacturing capital."[7/] Although some of these, such as Standard Oil, American Tobacco, U.S. Rubber, Pittsburgh Plate Glass, and American Sugar Refining, were created prior to 1898, Nelson reports that the book value of mergers for 1898-1902 came to 53 percent of all corporate manufacturing and mining assets.[8/]

The Changing Character of Mergers

Our successive merger waves have, in addition to becoming progressively smaller in relative terms, also changed character. The consolidations occurring as we entered the twentieth century were largely horizontal combinations. That is, firms were merged which produced the same products and sold in the same markets. They were competitors. Some were conglomerate combinations although they produced and sold the same products. Because they sold their products in different markets, we refer to these combinations as chain or market extension mergers--one variety of conglomerate merger.

The mergers of the 1920s were more often conglomerate or vertical mergers than the turn-of-the-century consolidations, and they were more often acquisitions than consolidations. The conglomerate merger category includes several

sub-categories--market-extension, product extension, and pure conglomerate. When Borden Company, operating a dairy in New York City, acquired a dairy in another city to which it shipped none of its fluid milk products, the merger was classified as a market extension acquisition. When Procter & Gamble acquired Clorox, which sold liquid bleach to the same grocery stores to which P&G sold soap, this was categorized as a product extension merger. And when United Aircraft bought the Otis Elevator Company, the transaction was classified as a pure conglomerate merger.

In addition to being predominantly horizontal in character, late nineteenth century mergers were also, to a large extent, simultaneous consolidations of several companies. That is, three or more firms were combined to form a new corporate entity. "Seventy-five percent of 1895-1904 firm disappearances took place by the consolidation of five or more firms."[9/] In the 1920s, consolidations accounted for only 30 percent of merger value and 36 percent of firm disappearances.[10/] By the 1960s, consolidations became rare events.

In the 1960s merger wave, conglomerate acquisitions dominated in contrast to the dominance of horizontal acquisitions in the 1920s (see table 2) and their even greater importance around 1900 when almost industry-wide consolidations were abundant. The change after 1950 was largely a consequence of the 1950 Celler-Kefauver anti-merger amendment to the Clayton Act.

Mergers and Industrial Concentration

The Celler-Kefauver Amendment was passed in 1950 with the urging of the Federal Trade Commission. It had concluded, in a 1948 report on mergers, that, "If nothing is done to check the growth in concentration . . . the giant corporations will ultimately take over the country . . . [Without] the proposed amendment to the Clayton Act, . . . the rise in economic concentration cannot be checked."[11/]

The Federal Trade Commission staff was mistaken in its view that a "rise in economic concentration" was taking place. Professor M. Adelman, reviewing material in this report, tells us that the number of mergers in the years preceding the report was low by comparison with earlier years.

"The Commission, however, for reasons not explained in its report, interpreted the low rate of mergers as evidence that the mergers were actually 'increasing concentration' and 'strengthening the position of big business.'"[12] Adelman rebuts the Commission's conclusions, reporting that, "The painstaking work of Lintner and Butters has shown that the 1940-47 merger movement had little or no effect on concentration."[13]

Table 2

PERCENTAGE DISTRIBUTION OF MEDIUM AND LARGE MERGER DISAPPEARANCES BY TYPE OF ACQUISITION, 1926-78

Type of Merger	1926-1930	1940-1947[a]	1948-1953	1954-1964	1965-1978
Horizontal[c]	64	62	31	18	14
Vertical	5	17	10	15	8
Conglomerate	31	21	59	67	78
Market Extension	(12)	(b)	(7)	(7)	(3)
Product Extension and other	(19)	(21)	(52)	(60)	(75)
Total	100	100	100	100	100
Number of Disappearances Classified	486[d]	2062	58	662	1272[e]

Source: Carl Eis, "The 1919-1930 Merger Movement in American Industry," Journal of Law & Economics, vol. 12, no. 2 (Oct. 1969), p. 294, Table 16; Bureau of Economics, Federal Trade Commission, Statistical Report on Mergers and Acquisitions (Washington, D.C.: U. S. Government Printing Office, Aug. 1980), p. 115, Table 18.

[a]Includes small mergers as well as medium and large acquisitions.

[b]For this period, the FTC included market extension mergers in the horizontal group.

[c]Quite a number of mergers classified by the FTC as horizontal involved very small product overlaps. In many of these mergers, the largest proportion of the product of the acquired firm was vertically related or was a product extension.

[d]Eis found the total number of manufacturing and mining companies acquired in this period (reported in the press) to be 1946. Only the larger acquisitions were categorized. W. L. Thorp, using Standard Corporation records, reports 4,838 manufacturing and mining firms acquired in this period.

[e]Not included in the tabulation of acquired firms with assets of $10 million or more are companies for which data were not publicly available. There were 382 such companies for the period 1965-1978 and 137 such companies for the period 1948-1964. The rise in annual number of acquisitions from 10 in 1948-1953 to 60 in 1954-1964 to 90 in

1965-78 overstates the actual rise in medium and large acquisitions since the $10 million cutoff was stated in current, not constant, dollars.

Not only Adelman has criticized this piece of FTC research; Justice Stevart, dissenting in U.S. v. Von's Grocery Co., said

> Much of the fuel for the congressional debates on concentration in the American economy [prior to the passage of the Celler-Kefauver amendment to the Clayton Act] was derived from a contemporary study by the Federal Trade Commission on corporate acquisitions between 1940 and 1947. See Report of the Federal Trade Commission on the Merger Movement: A Summary Report (1948). A critical study of the FTC report, published while the 1950 amendment was pending in Congress, concluded that the effect of the recent merger movement on concentration had been slight. Lintner & Butters, Effect of Mergers on Industrial Concentration, 1940-1947, 32 Rev. of Econ. Statistics 30 (1950). Two economists for the Federal Trade Commission later acquiesced in that conclusion. Blair & Houghton, The Lintner-Butters Analysis of the Effect of Mergers on Industrial Concentration 1940-1947, 33 Rev. of Econ. & Statistics 63, 67, no. 12 (1951).14/

In the same article in which he impeached the FTC summary report on The Merger Movement, Professor Adelman also examined the Federal Trade Commission Report on the Concentration of Productive Facilities, 1947 (Washington, 1949). He found that the conceptual basis of the measure of concentration used was inadequate and produced misleading results.

> The report used . . . "net capital assets" as the best measure of size and concentration and applied it to 26 industries, despite the fact that this measure accounts for only one-third of all assets. Some explanation is obviously necessary for this omission of two-thirds of the information.
> . . .
>
> The exclusion of inventories--part of the "ideal" figure--from the measure of concentration is the strangest part of the whole procedure. It is explained as follows:
>
> "According to reports of the Senate Small Business Committee, numerous small firms experienced great difficulty during that year [1947] in obtaining adequate inventories of raw materials. If inventories were thus relatively shorter in small than in large firms--as there is every reason to believe was the case--the inclusion of inventories in the measure would have the effect of overstating the degree of economic concentration.15/
>
> Setting aside the question of the reliability of the evidence, our concern is with the logic of the procedure. A glance at Table I will show that the over-$100 million group held 35.6 per cent of inventories. According to the report, this was an abnormally high percentage. In a more representative year, that is, it would be lower.

> Suppose we were to disregard this qualification for the moment, and add inventories to net capital assets to obtain net tangible assets--the "ideal" figure--as a measure of concentration. Then the percentage held by the largest corporations would be not 46.1 per cent but 41.1. But in a normal year, according to the report, the largest corporations would have held a smaller proportion of inventories than 35.6 per cent and therefore a smaller proportion of total tangible assets than 41.1 per cent. The FTC explanation can therefore be paraphrased as follows: to have used the estimate of 41.1 per cent would have resulted in an overestimate of the degree of concentration; therefore, we are using an estimate of 46.1![16/]

That the FTC reports in 1948 and 1949 were mistaken in their conclusions is further demonstrated by Bureau of the Census data on concentration which has become available. Although the 1940-1947 period was characterized by the FTC in its 1948 report as a third merger wave rivaling the turn-of-the-century and the 1920s wave, with the acquisition of more than 2,000 firms, the average concentration ratio was unaffected. It was 40.2 percent in 1935 (see table 3) in the 272 industry groups for which the Bureau of the Census disclosed concentration data. The Bureau used 281 groupings for all manufacturing. Using a minimum estimate of concentration in the remaining nine industries, the average concentration ratio was 41.8. It failed to rise by 1947 despite a finer subdivision of manufacturing into 463 industries by the Bureau in its 1947 measurement. This finer subdivision of manufacturing would be expected to raise the average concentration ratio. Yet, average concentration fell to 39.7 percent in 1947.

Table 3

Distribution of Manufacturers' Shipments by
Four-Firm Concentration
1935, 1972, 1977

Four-Firm Concentration	Percentage Share of Shipments[a]		
	1935[b]	1972	1977
0 - 9.9	16.6 (20)	5.4 (17)	6.0 (20)
10 - 19.9	13.5 (40)	16.4 (70)	17.0 (72)
20 - 29.9	17.0 (44)	20.0 (97)	16.8 (96)
30 - 39.9	14.5 (50)	14.8 (72)	18.4 (68)
40 - 49.9	10.6 (31)	10.9 (61)	11.0 (64)
50 - 59.9	6.9 (25)	10.7 (57)	11.0 (58)
60 - 69.9	7.6 (26)	9.1 (28)	7.4 (30)
70 - 79.9	2.8 (17)	4.1 (26)	4.2 (18)
80 - 89.9	9.2 (18)[c]	1.4 (11)	2.5 (19)[h]
90 - 100	0.2 (4)[d]	7.2 (11)[g]	5.8 (4)[i]
0 - 59.9	79.1 (210)	78.2 (374)	80.2 (378)
60 - 100	20.9 (71)[e]	21.8 (76)	19.8 (71)
Weighted average concentration	37.0 (272)	40.2 (450)	39.1 (446)
Simple average concentration	40.2 (272)[f]	39.1 (450)	38.4 (446)

[a]Number of industries in each group is in parentheses. The Census has 451 manufacturing industries in its 1972 Standard Industrial Classification code, but it combined industries 3572 and 3579 in calculating concentration ratios for 1972 and 1977.

[b]Does not add to 100 because of the omission of six industries whose concentration was not disclosed. The Bureau of the Census combined eighty-two textiles and their products industries into twenty-two for its concentration report.

[c]Industry 1003 included here but not in the calculation of average concentration in all manufacturing.

[d]Industries 624 and 1314 included in this group but not in the calculation of average concentration for all manufacturing for lack of precise four-firm concentration figures. The six industries omitted for lack of data probably belong in this group. If they were included, the share of shipments would be 1.3.

[e]Includes six industries for which concentration data were not disclosed.

[f]If we include nine industries, for which concentration data were not disclosed, at their minimum concentration ratios, the simple average becomes 41.8 instead of 40.2.

[g]For SIC 3661, telephone and telegraph apparatus, the 1970 figure of ninety-four was used since the Census Bureau did not disclose the figure for 1972.

[h]Industries 2111 and 3661 are included here (although the Bureau of the Census did not disclose four-firm concentration data for these industries) but not in calculation of average concentration in all manufacturing for 1977.

[i]Industry 2823 included here (although the four-firm concentration figure was not disclosed) but not in average concentration in all manufacturing.

Source: U.S. Department of Commerce, Bureau of the Census, Census of Manufactures, 1972, Concentration Ratios in Manufacturing, MC76 (SR)-2 (Washington, D.C.: U.S. Government Printing Office, Oct. 1975), Table 5; Bureau of the Census, Concentration Ratios in Manufacturing (Washington, D.C.: U.S. Government Printing Office May 1981), table 7; National Resources Committee, The Structure of the American Economy (Washington, D.C.: U.S. Government Printing Office, June 1939), Table 1, p. 265;

Examining the 126 industries with unchanged definitions from 1935 to 1947, we find that the majority of highly concentrated industries became less concentrated despite the prevalent very permissive merger policy of the period. The majority of those which were unconcentrated became more concentrated. This convergence toward the average concentration ratio apparently was the consequence of a centripetal tendency which also characterizes the later period, 1947 to 1972, when important horizontal mergers were no longer permitted (see table 4).[17/] Among those industries in which four

firms shipped 75 percent or more of their industry's product in 1935, concentration decreased in 53 percent by 1947. It increased in only 24 percent. In the industries where concentration was 24 percent or less, concentration decreased in 20 percent and increased in 52 percent. Professor Walter Adams observes, of this period, that

> . . . here indeed is an eloquent testimonial to the dynamism and competitiveness of the American economy. Here indeed is a graphic manifestation of the competitive forces in the economy--holding their own despite a public policy which left the highway to monopoly [horizontal mergers] unblocked and unguarded.[18/]

To Professor Adams' observation, we can add that mergers since the turn of the century, as well as those of the 1940-1947 period, apparently did not increase average industrial concentration, despite their predominantly horizontal character up to the 1950s. Warren Nutter estimated that 33 percent of manufacturing value added between 1895 and 1904 came from industries whose four-firm concentration ratio exceeded 50 percent.[19/] By 1954, the share of value added in manufacturing by industries more than 50 percent concentrated dropped to 30 percent.[20/]

Table 4

Percentage of Industries with Rising, Stable, or Declining Concentration by Concentration Level, 1947-72

Concentration range in 1947	Number of industries[a] 1947	More than 2 percentage points increase in concentration 1947-72	Stable concentration 1947-72	More than 2 percentage points decrease in concencentration 1947-72
		Percentage		
0-24	58	71	14	15
25-49	53	42	25	34
50-74	33	24	15	61
75-100	21	24	5	71
	165			

[a]The industries selected are all those whose definitions were essentially unchanged from 1947 to 1972 for which concentration data are available.

Source: U.S. Bureau of the Census, Concentration Ratios in Manufacturing.

The Legacy of the Turn-of-the-Century Merger Movement

Economists and statisticians have, in times past, argued that the consolidations late in the nineteenth century (which created firms with more than 50 percent market shares in seventy-eight industries, in twenty-six of which corporations had been formed with market shares of more than 80 percent) left a permanent stamp on the structure of American industry. But the fact is that the horizontal consolidations in the two decades through 1902 produced a structural legacy which is little different than it would have been without the large consolidations.

In the industries where concentration produced efficiencies and the consolidations were efficiently managed, they remained preeminent, although their market shares declined as their industries grew (see table 5). In those industries where concentration did not produce efficiencies or the consolidations were not well managed, the combinations failed or had to be reorganized (see table 6). None succeeded in maintaining monopoly prices although some tried (notably American Sugar Refining Co., which owned 98 percent of sugar refining capacity east of the Rockies, and American Can with 90 percent of can making capacity).[21/]

That many industries and their customers benefited from the horizontal mergers is demonstrated by the price movement in industries with important consolidations relative to those with minor consolidations and those with no consolidations. The National Industrial Conference Board found that in twenty-six industries in which important consolidations took place, for which price data were available, prices fell by 13 percent from 1900 to 1913 and then rose by 49 percent from 1913 to 1925. In twenty industries in which no consolidations occurred, prices rose by 10 percent from 1900 to 1913 and then rose another 96 percent from 1913 to 1925 (Figure 1).

Table 5

Market Shares of Selected
Turn-of-the Century Combinations

Company	Early Share		Later Share	
	Percentage	Year	Percentage	Year
Standard Oil	88	1899	67	1909
American Sugar Refining	95	1892	75 49 28	1894 1907 1917
American Strawboard	85-90	1889	33	1919
National Starch Mfg. Co.	70	1890	45	1899
Glucose Sugar Refining Co.	85	1897	45	1901
International Paper	66	1898	30 14	1911 1928
American Tin Plate Co.	95	1899	54	1912
American Writing Paper	75	1899	5	1952
American Tobacco[a]	93	1899	76	1903
American Can	90	1901	60	1903
U.S. Steel[b]	66	1901	46	1920
International Harvester[c]	85	1902	33 44 23	1934 1922 1948
American Smelting and Refining	85-95	1902	31	1937
Corn Products Refining	90	1906	59	1914

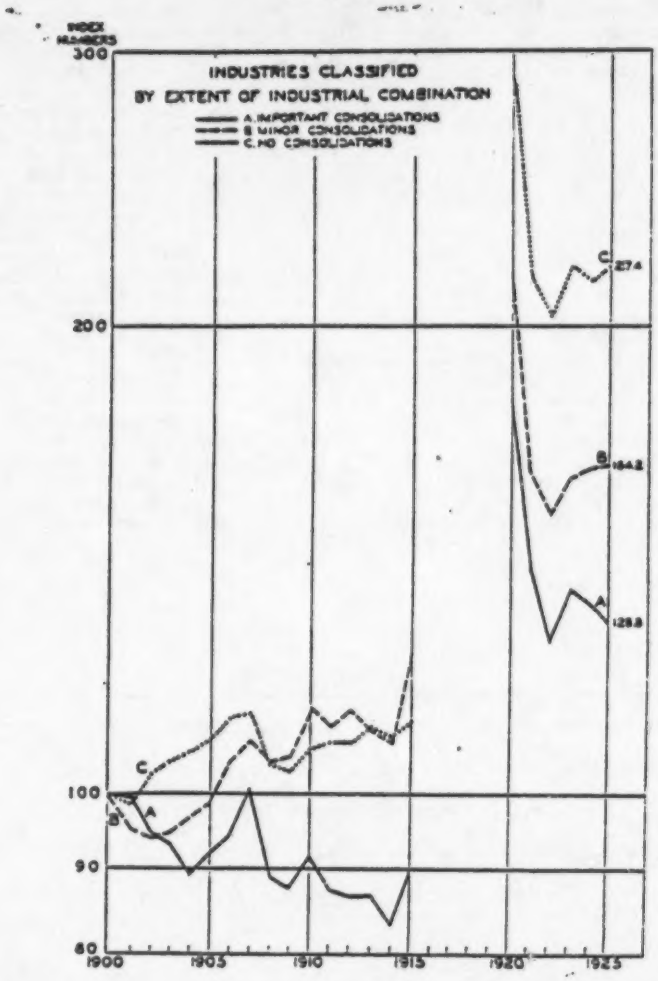
[a]Share of cigarette sales.

[b]Share based on steel ingot castings. A weighted average of ten products gives U.S. Steel 57 percent of the market in 1901 declining to 47 percent in 1913. A. S. Dewing, Corporate Promotions and Reorganizations (Cambridge: Harvard University Press, 1914), p. 527. U.S. Steel's share dwindled despite additional large acquisitions in 1904 and 1905.

[c]Under a 1918 antitrust consent decree, Harvester disposed of its Champion and Osborne lines of harvesting maninery in 1919. These accounted for less than 10 percent of its output of four major implements and a smaller share of all farm machinery. S. Whitney, 2 Antitrust Policies (New York: Twentieth Century Fund, 1958), p. 230.

Figure 1

PRICE FLUCTUATIONS IN THREE GROUPS OF MANUFACTURING INDUSTRIES
Base, 1900 = 100



Source: National Industrial Conference Board, Mergers in Industry: A Study of Certain Economic Aspects of Industrial Consolidation (New York: National Industrial Conference Board, 1929), p. 146.

Table 6

1890-1905 Consolidations with Large Market Shares Failing Within a Few Years after Their Formation

1. American Bicycle
2. American Barrel & Package
3. American Cement
4. American Cotton Company
5. American Electric Heating
6. American Felt
7. American Fisheries
8. American Fork & Hoe
9. American Fruit Products
10. American Grass Twine
11. American Laundry Machinery
12. American Malting
13. American Saddlery & Harness
14. American Wood Working Machinery
15. American Wringer
16. Asphalt Company of America
17. Atlantic Rubber Shoe Co. of America
18. Booth, A. & Co.
19. Consolidated Railway Lighting & Equipment
20. Consolidated Railway Lighting & Refrigeration
21. Consolidated Rubber Tire
22. Continental Cotton Oil
23. Corn Products Co.
24. Development Co. of America
25. Distillers & Cattle Feeders
26. Distilling Co. of America
27. Electric Vehicle Co.
28. General Roofing
29. Glucose Sugar Refining Co.
30. Great Western Cereal
31. International Car Wheel
32. Mt. Vernon-Woodberry Cotton Duck
33. National Asphalt
34. National Cordage
35. National Glass
36. National Novelty
37. National Shear
38. National Starch
39. National Wallpaper
40. New England Yarn
41. Pope Manufacturing
42. Standard Rope & Twine
43. United Box Board & Paper
44. United Button Company
45. United Copper Company
46. United Zinc & Lead
47. U.S. Cotton Duck
48. U.S. Dyewood & Extract
49. U.S. Finishing
50. U.S. Leather
51. U.S. Reduction & Refining
52. U.S. Shipbuilding
53. U.S. Worsted

Rejuvenations

54. Allis Chalmers
55. American Colortype
56. American School Furniture
57. American Soda Fountain
58. Central Foundry
59. International Fire Engine
60. National Salt
61. U.S. Cast Iron Pipe
62. U.S. Flour Milling
63. U.S. Realty & Improvement

Note: These companies were classified as early failures on the basis that creditors suffered a loss within a decade after formation. The ten "rejuvenations" are classified separately on the basis of "a successful existence . . . subsequent to changes in capital set-up." Shaw Livermore, "The Success of Industrial Mergers," Quarterly Journal of Economics, vol. 50 (Nov. 1935), p. 90.

22

There is a wide variation in the degree of concentration among U.S. manufacturing industries (see table 3). Differing economic characteristics in each of the many industries cause this wide variation. Today's industrial structure is a result of this variation in characteristics. Joe Bain found (as did F. L. Pryor in a later study) that industries which are concentrated in the United States are concentrated in other countries. Those with low concentration are also the same abroad as in the United States.[22] This suggests that fundamental technological and economic forces determine industry structure and that it is little different today than it would have been without the turn-of-the-century consolidations.

In the absence of constraints on competition, such as those imposed by the Private Express Statutes or monopoly utility franchises, concentrated industries are concentrated because that is the efficient way to organize them. Unconcentrated industries are unconcentrated because that is the efficient way to organize them. As Professor Harold Demsetz pointed out

> My own studies . . . indicate that the more concentrated the industry, the lower are the costs of large firms relative to the costs of medium and small firms in those industries; this difference in costs is substantial. The cost advantage diminishes to insignificance for very unconcentrated industries. I believe that is why one set of industries is and remains concentrated and the other does not. This suggests that where concentration is found, it is largely a consequence of the competitive process, and that such industry structures are derived from those techniques yielding low-cost production. Competition would have altered concentrated structures if there were no associated efficiencies; in fact, many industries remain unconcentrated or have become unconcentrated because no special efficiencies or entrepreneurial successes have called forth and maintained concentrated structures.[23]

That concentrated industries and firms with large market shares are not entrenched in their positions is demonstrated by postwar experience as well by the late nineteenth and early twentieth century experience shown in tables 5 and 6. In the period from 1947 to 1977, there were over forty episodes in which highly concentrated four-digit industries experienced decreases of ten points or more in the share of business done by the leading four firms in those industries (see table 7). These occurred in thirty-seven out of forty-eight highly concentrated industries. Examining the incomplete data for five-digit product classes for 1947-1972, we find more than 240 cases of decreases in four-firm concentration ratios of ten percentage points or more. These experiences substantiate Professors Demsetz's conclusion that "competition . . . alter[s] concentrated structures if there [are] no associated efficiencies."[24/]

Competition is constantly at work altering industry structures, moving them toward their equilibria, which are, themselves, being moved by changing circumstances. A changing structural equilibrium results from changes in tastes, resources, technology, or institutional factors (such as tariffs and government regulations). Industrial structure is neither arbitrary nor immutable. Rather it is the result of efforts by market participants to achieve their ends at least cost, and, as changes in a variety of industries demonstrate, is influenced by changing conditions.

Conclusion

Apparently there need be little concern about horizontal mergers. Where they are inefficient and yield no benefit to their customers, their market share soon dwindles. Where they are efficient, they persist and their customers benefit. To forbid horizontal mergers simply causes an industry to approach

Table 7
HIGHLY CONCENTRATED INDUSTRIES WITH DECREASES OF TEN POINTS OR MORE IN INDUSTRY OR PRODUCT GROUP CONCENTRATION RATIOS 1947-1977

		Four-Firm Share of Industry (I) or Product Group (P) Shipments													
		1947		1954		1958		1963		1967		1972		1977	
	Industry	I	(P)	I	(P)	I	(P)	I	(P)	I	(P)	I	(P)	I	(P)
2045	Blended and prepared flour							70						51	
2046	Corn milling	77										63			
2052	Biscuits and crackers	72						59							
2085	Distilled liquor	75		64				58				47			
2111	Cigarettes	90				79									
2141	Tobacco stemming	88		73						63					
2271	Woven carpets											78		67	
2646	Molded pulp	86		72											
2811	Sulfuric acid			82	(D)								(55)		
2813	Industrial gases			84				72							
2824	Organic fibers							94		84		74			
2833	Medicinals and botanicals									74		59			
2841	Soap and detergents							72				62			
2861	Gum and wood chemicals									70				59	
2892	Explosives			79						67					
2898	Salt				(83)								(70)		
2999	Petroleum and coal prods., n.e.c.									82				67	
3021	Rubber footwear	81				65									
3031	Reclaimed rubber	84		73				93				78			
3229	Pressed glass, n.e.c									71				61	
3275	Gypsum products			90						80					
3313	Electrometallurgical prods.	88				73		79						69	
3331	Primary copper					87				77					
3334	Primary aluminum			100								79			
3352	Aluminum rolling	94				78									
3392	Nonferrous forging						(70)		(56)						
3411	Metal cans					80						66			
3463	Nonferrous forgings							84				71			
3511	Turbines and generator sets							93		76					
3574	Calculating machines									83		73		59	
3612	Transformers			78				68						56	
3652	Phonograph records	79						69		58		48			
3673	Electron tubes, transmitting									70		55			
3723	Aircraft propellers				(90)						(77)				
3932	Organs			81		71									
3933	Piano and organ parts						(74)		(48)						
3982	Cork products						(67)				(46)				

Source: Bureau of the Census, Concentration Ratios in Manufacturing (Washington, D.C.: U.S. Government Printing Office, May 1981), Tables 7 and 9.
Note: The I column shows the four-firm concentration ratio in each industry at the time of the industry's peak concentration and at the subsequent time when it had dropped by at least 10 percentage points. The (P) column shows similar data for product group concentration.

its efficient structure by a more costly route. It forecloses the opportunity for smaller firms to sell out on favorable terms. "The principle effect of a very strict rule against horizontal mergers is not to retard economic progress, it is to reduce the sale value of small firms."[25] Professor Joe Bain adds that where the equilibrium structure of an industry is one of high concentration, a high

> . . . degree of seller concentration would emerge more or less automatically as a result of competition even if sellers were initially many and small. If there are important economies of the large-scale firm, so that to approach optimal scale a firm must supply a significant fraction of the market, atomistic competition among many firms will lead all to expand. This expansion will drive price down until only large-scale firms can survive, eliminating all but a few firms, and will thus "automatically" produce an oligopolistic or concentrated market structure.[26]

Forbidding horizontal mergers, then, may simply force many firms into voluntary liquidation or bankruptcy (or into selling out to a conglomerate where the economies of size are not product-specific). The capital invested in their facilities and organization is wasted while the growing firms commit capital to enlarging old plants or building new plants--capital that could be applied to alternative uses instead of building redundant capacity.

The beer industry provides a classic example of the building of redundant capacity by growing firms because the merger route for acquiring additional capacity and for expanding into new markets was foreclosed. Despite the application of a strict antitrust enforcement policy against mergers, the concentration ratio in brewing rose from 11 percent in 1935 to 63 percent in 1977 (and the number of firms decreased from 756 in 1934 to 49 in 1976).[27]

The FTC's Bureau of Economics believes that antimerger policy may actually have promoted higher concentration in the industry. It says

> The fact that mergers have accounted for such a small share of the increase in concentration is directly a result of very strict antitrust enforcement by the Justice Department. But this policy may have, in the end, promoted higher national concentration in two ways: (1) By foreclosing the merger route to the national brewers,

> it forced them to expand internally. As we have seen, their large new breweries are more efficient than the older smaller ones. . . . (2) The Department has blocked merger of smaller brewers. This may have had the effect of weakening the competitive position of the latter group of firms.[28]

The result of the large amount of new brewery capacity built by firms which were not allowed to buy existing breweries was that the industry found itself saddled with 40 percent excess capacity. Much of this was junked and the capital wasted.

This suggests that the new guidelines for horizontal mergers, which the Department of Justice intends to issue in the near future, should be much less strict than the 1968 limits it enunciated. The Presidential Task Force on Productivity and Competition's 1969 report also argues that "The Department of Justice Merger Guidelines are extraordinarily stringent and in some respects indefensible."[29]

Chapter 3

Conglomerate Mergers and Efficiency

In 1979, when Senator Howard Metzenbaum opened the hearings on S. 600, a bill designed to stop conglomerate mergers by corporations with assets or sales exceeding $350 million, he said,

> . . . it's hard to make a convincing case that putting cigarettes, Hawaiian punch and offshore oil and gas under one corporate umbrella will have any startling effects on the efficiency with which our economy operates. There is of course some argument about capital allocation, managerial skills, and so forth. But the consensus . . . among industrial or organizational economists, is that most large conglomerate mergers, are at best neutral, with respect to efficiency, and actually may have adverse effects in many instances.[1]

Neither Metzenbaum nor any witness at these hearings provided any evidence that conglomerate mergers do not improve efficiency. Professor Dennis Mueller thought he provided such evidence by citing a survey of the research on the profitability of investing in the acquisition of companies. He testified that the survey showed that "no one who has undertaken a major empirical

study of mergers has concluded that mergers are profitable, i.e., profitable in the sense of being 'more profitable' than alternative forms of investment." Mueller concluded "that mergers neither increase nor decrease economic efficiency on average."[2/]

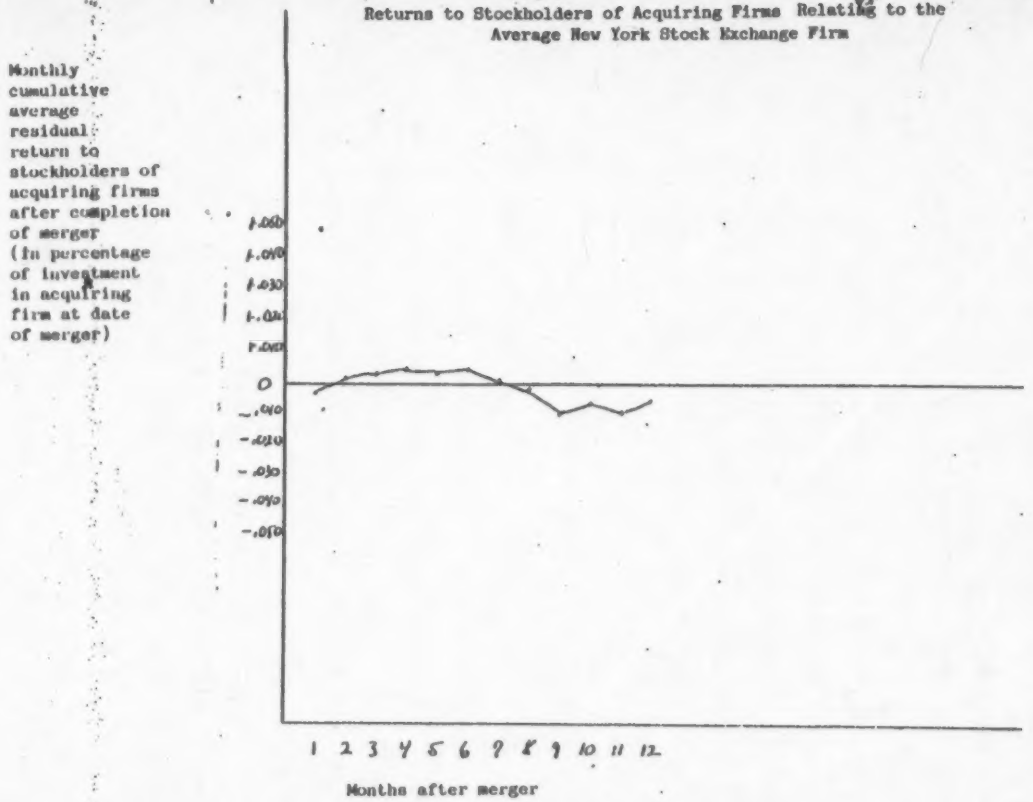
Financial Evidence Showing Mergers Improve Efficiency

That acquiring companies, on the average, earned only normal returns on their investments in acquisitions should not be surprising. The average return on all investments is equal to the normal return. Any class of investments on which above average returns can be earned does not long remain in that position unless knowledge of such investments is a secret. Once such investments become known, investors bid their prices to the level where only normal returns are earned. If the market for acquisitions is competitive, then acquirers can be expected to earn only as much, on average, as they would earn in "alternative forms of investment."

Acquirers of New York Stock Exchange listed firms in the postwar years paid substantial premiums for their acquisitions. The premiums averaged 25 percent from 1955 through 1976 on the price prevailing before each merger or tender tender offer announcement.[3/] Even these pre-offer values were influenced by the expectation that a bid would be forthcoming. They would have been lower but for that expectation. For the acquired firms where there was no expectation that someone would offer to buy them (the merger offer came as a complete surprise), the premiums averaged more than 50 percent.[4/] In recent years, premiums have trended upward, reaching 50 percent in 1979.

The fact that premiums were paid suggests that the acquirers expected they would employ the acquired assets more efficiently than they were previously used. Premiums would be offered only if the buying firms expected to produce returns of greater value to their stockholders than the value to acquired firm's stockholders of the expected returns under the old managements. Since the acquirers' stockholders enjoyed returns following the mergers roughly equal to those of all NYSE firms (see Figure 2), the expectations were accurate. A marked improvement in the value of the returns must have occurred subsequent to the acquisition. Otherwise, the premiums paid would have produced losses in the acquiring companies. They would have suffered below normal returns with a consequent loss to their stockholders

Figure .
Returns to Stockholders of Acquiring Firms Relative to the Average New York Stock Exchange Firm



Source: Paul Asquith, Mergers and the Market for Acquisitions (mimeo, Jan. 1979).

if the premiums had not been subsequently justified and their value sustained by efficiency improvements.

Professor Paul Asquith points out that findings in his study of postwar mergers show that

> [M]ergers cause a change in real activity, and this change produces a real gain for the combined firm. That is, the firms are worth more when they are combined than when they are alone. . . .
>
> Furthermore, the results suggest that the resource which is being acquired in a merger is . . . [an] inefficient[ly] manage[d] . . . target firm.[5/]

Other Evidence of Conglomerate Efficiency

That conglomerates are more efficient, or at least use their labor more productively, than single-industry enterprises was demonstrated by Professor Victor Fuchs in his examination of the Company Statistics portion of the 1954 Census of Manufactures. Fuchs found that value-added per employee in conglomerates exceeded that in single-establishment companies by 28 percent. It exceeded that in multi-unit, single-industry companies by 11 percent. Also, conglomerates paid their employees 9 percent more than single-unit firms and 4 percent more than multi-unit, single-industry firms.[6/] On average, conglomerates produced 22 percent more with each worker than single-industry firms and paid their workers 7 percent more in 1954 (see table 8).

An analysis of the 1963 Census of Manufactures enterprise statistics shows even greater productivity and pay rates in conglomerates, relative to single-unit and multi-unit, single-industry companies, than in 1954. The amount by which value-added per employee in conglomerates exceeded value-added in single-unit firms rose from 28 percent in 1954 to 38 percent in 1963. Conglomerate value-added per employee rose from 11 percent to 15 percent more

Table 8

Comparisons of Value-Added and Wages per Employee in Conglomerate Firms and Single-Industry Firms

Ratio of Conglomerate Firm Employee Productivity (or Wage) to Single-Industry Firm Employee Productivity (or Wage)	Number of Enterprise Industries in Each Range of Ratios of Conglomerate Firm Employee Productivity to Single-Industry Firm Employee Productivity			Number of Enterprise Industries in Each Range of Ratios of Conglomerate Firm Wage Rate to Single-Industry Firm Wage Rate		
	1954	1963	1972	1954	1963	1972
2 and over	1	4	1	..	..	..
1.90-1.99	2	3	1	..	..	..
1.80-1.89	0	2	0	..	..	..
1.70-1.79	1	3	3	..	..	..
1.60-1.69	3	2	2	..	..	..
1.50-1.59	1	5	1	..	..	1
1.40-1.49	6	6	6	1	3	2
1.30-1.39	7	13	7	0	3	5
1.20-1.29	14	14	12	8	13	6
1.10-1.19	19	31	23	22	38	28
1.00-1.09	13	16	11	27	36	32
.90- .99	7	6	14	18	14	14
.80- .89	4	2	8	2	..	1
.70- .79		0	2	..	..	..
Total number of industries	78	107	91	78	107	91
Median	1.15	1.19	1.13	1.07	1.10	1.09
Mean	1.22	1.30	1.17	1.07	1.11	1.10

Source: U. S. Bureau of the Census, Enterprise Statistics: 1963, Part 1, General Report on Industrial Organization (Washington, D.C.: U. S. Government Printing Office, 1968), Table 5A; Enterprise Statistics (Washington, D.C.: U.S. Government Printing Office, 1977), Table 2.

than multi-unit, single-industry firms between 1954 and 1963. Pay rates in conglomerates rose from 9 percent more than single-unit firms in 1954 to 13 percent more in 1963. Wage rates in conglomerates rose from 7 percent more than single-industry firms in 1954 to 11 percent more in 1963 (see table 8).

This disequilibrium in 1963 may have been one of the more important reasons for the conglomerate merger wave of the 1960s. Why the increase in the disequilibrium occurred, between 1954 and 1963, we do not know. Whatever the reason, the rise in conglomeration in the 1960s brought the economy back toward a structural equilibrium between 1963 and 1972. Value-added per employee fell from 30 percent greater in conglomerates in 1963 than in single-industry firms to 17 percent greater in 1972 (measured by arithmetic means) as a result of the reallocation of resources from single-industry to multi-industry firms (see table 8). This suggests that it was the less efficient single-industry firms that conglomerates acquired. It was in these that conglomerates could bring about improvements in output per employee.

In this respect, the conglomerate merger wave of the 1960s may have been similar to the horizontal mergers of the 1930s and 1940s. Most of the firms acquired in those horizontal mergers had sub-optimal capacity.[7] Combining their assets by merger formed firms with a larger, more economic scale of operation. These mergers achieved efficiencies without creating excess capacity and driving some less than optimum-sized firms into bankruptcy or voluntary liquidation--a more costly process for increasing productivity.

Sources of Conglomerate Efficiency

The sources of the greater productivity of employees of conglomerates have not been determined. Perhaps the joint use of warehouses, delivery trucks, sales forces, and the use of pool car shipments result in economies in the case of some product-extension mergers.[8] Perhaps they replace incompetent managers in acquired firms. Perhaps conglomerates are quicker to take action when performance in a division lags. Perhaps conglomerates move more rapidly to discontinue inefficient or unproductive operations than single-industry companies and to move their employees and capital into more productive uses. Perhaps they do not throw good money after bad.[9] Perhaps their ability to raise capital at less cost than smaller or less diversified firms enables them to use more capital-intensive technology. Perhaps the internal capital markets of

conglomerates in a day of shortened product-life cycles work more efficiently than impersonal capital markets.[10]

The opportunity to use an internal capital market rather than going to external sources can be crucial when financing is necessary in order to make use of proprietary information. A firm seeking capital from outside the company to apply new technology developed in its research department may have to disclose some of the information on its new development in order to obtain funds less expensively. But disclosing the information may dissipate some of its value since competitors may, as a consequence, come into the market more quickly.

> The subsidiaries of a conglomerate can disclose proprietary information to corporate headquarters, and thus the corporation can allocate its capital based on a full information set. . . . This is . . . why the internal capital market of a large firm may be a more efficient allocator of capital than the external capital market.[11]

Professor Richard Nelson, in his analysis of "The Simple Economics of Basic Scientific Research," concluded that conglomerate firms obtain a better return on their investments in research and development because they "have their fingers in many pies." Their interests in many fields enable them to produce and market a larger proportion of the unexpected inventions that occur in their research efforts and they make more use of basic research. According to Nelson

> A broad technological base insures that, whatever direction the path of research may take, the results are likely to be of value to the sponsoring firm. . . . It is not just the size of the companies that makes it worthwhile for them to engage in basic research. Rather it is their broad technological base, the wide range of products they produce or will be willing to produce if their research efforts open possibilities. . . . Strangely enough, economists have tended to see little economic justification for giant firms not built on economies of scale. Yet it is the many-product giants not the single-product giants, which have been most technologically dynamic.[12]

Conglomerates, by increasing their size through their acquisitions, may also economize in staff functions. A study by Professor Peter Pashigian of

the 284 respondents (most of whom were conglomerates) to a questionnaire on legal costs sent to the leading 500 industrial firms, found a strong inverse relationship between legal costs per million dollars of sales and size (see table 9). If the average cost of other staff functions per dollar of sales drops anywhere near as rapidly as legal costs, these economies may be a factor in the willingness of conglomerates to pay substantial premiums for their acquisitions.[13] These economies make it possible to earn a normal return on these investments despite the large premiums paid.

Perhaps, as Harold Geneen, former president of International Telephone and Telegraph explained, a conglomerate "has numerous individual specialists and experienced managers in many fields, and . . . the very untraditional outlook such a company brings to an industry is the key to innovation and new progress."[14]

Table 9

Legal Costs per Million Dollars of Sales by Firm Size

Approximate Average Sales Size of Firms ($ millions)	Average Legal Costs per $1 million of of Sales
$300	$2,227
750	1,527
1,000	1,085
Over 2,000	440

Source: B. Peter Pashigian, The Legal Costs of Firms: Prevention versus Legal Defense (presentation before the Law and Economics Workshop, University of Chicago, May 20, 1980).

When Mobil acquired Montgomery Ward, it placed its own credit management specialists in Wards's troubled credit operation. Also, it loaned real estate experts and location specialists from its filling station location group to Wards' store location group. In addition, it applied its retailing expertise and its purchasing know-how to Ward's operation. The superior management and staff of a firm may enable it to improve operations in other firms lacking such management and such staffs.[15]

The "Consumption" of Capital by Acquirers

Opponents of the merger movement frequently argue that the use of borrowings by Du Pont, for example, to acquire Conoco or by Mobil, for another example, to acquire General Crude Oil Co. would do more for the nation if used by acquirers to build new plant, to do more innovating, or to find new oil rather than acquiring already discovered oil and already built plants. They believe that the use of capital in the acquisition process denies capital to real capital formation.

The simple correlation of assets acquired by manufacturing and mining firms with spending on the creation of new assets is very high. The correlation coefficient is 0.85. The acquisition of old and new assets is not a process in which the spending on old assets diverts capital from the creation of new assets. An increase in the demand for old assets encourages the creation of new assets. We recognize this in the case of housing, yet do not apply the same reasoning to other assets. That an increase in the demand for old houses will increase the demand for new houses is a part of the conventional wisdom. The same principle applies to other assets.

If a firm finds it cheaper to buy already discovered oil rather than engaging in discovery itself or adding to its current discovery effort, this simply says that it is less efficient at discovery than others or that the added effort would be less efficient.[17] By buying already discovered oil, it increases the demand for discovered oil. Those who have discovered oil and are more efficient in discovery sell their reserves and are provided with the capital to engage in additional discovery. Those who have invested in acquired companies which have discovered oil are provided with the capital to invest in other discoveries of oil. The result is additional investment in new discovery whether the capital is invested directly by a Mobil or indirectly by its purchase of already discovered reserves. Even if those who sell their positions in already discovered oil do not themselves reinvest in more discovery, others are encouraged to invest by the demand for discovered oil.

To put this another way, an acquisition does not consume the real resources required for the creation of new assets. The purchase of one company by another simply transfers title. It does not divert the real resources used to create new assets to non-creation uses. If anything, acquisitions of existing assets attract additional real resources into creating more new real assets. Remember

the correlation between the purchase of existing assets and the creation of new assets.

By choosing to buy existing assets, such as already discovered oil where this is cheaper for a firm than discovering its own, the process of creating new assets such as newly discovered oil is made more efficient. Those who are most efficient at the discovery process will engage in it and sell to those who are less efficient. To bar such acquisitions will make the discovery process less efficient and reduce the amount of oil discovered both for this reason as well as because of the forced reduction in the demand for already discovered oil.

Conclusion

Whether conglomerates increase the efficiency of the American economy is a question that has baffled many observers. How can putting cigarettes and Hawaiian Punch under one corporate umbrella have any startling effects on efficiency? Whether or not the answer is apparent to the naked eye is irrelevant. There may be as many different reasons for an increase in efficiency resulting from conglomerate mergers as there are efficient mergers, not one or a few answers applicable to a wide variety of cases. For this reason, no single answer can be discovered.[16/] There have been and will continue to be instances in which it is clear, after the fact, that a merger was a mistake. But it should be even clearer that to prevent mistakes government would have to prevent people from making decisions. If our capital, labor, material, and product markets function competitively, they will accord rewards to those that are efficient and losses to those which are not.

Many acquisitions were mistakes. Some conglomerates overreached themselves. Some large firms overexpanded. But the market cured this. Would-be conglomerates that failed to manage acquired assets as competently as others could, as apparently was the case at Whittaker Corporation and Ling-Temco-Vought, were forced to disgorge some of their acquisitions and reorganize their operations to stay alive. American Brands, W. R. Grace, and other conglomerates have sold portions of their acquisitions to finance their activities and to confine their operations to what they can manage well. Professor W. G. Shepherd found that

> Many mergers are divestitures rather than a combination of two free-standing companies. Such selling off of branches rose in 1975 to 54 percent of all acquisitions

(by number), up from 11 percent in 1967 and 39 percent in 1973.[17/]

What is surprising is that evidence of greater relative efficiency in conglomerates shows so strongly in the data (table 8). It would not if the economy were in a long-run, static, structural equilibrium. With full adjustment to tastes, resources, and technology, wage rates and productivity would be no higher in multi-industry than in single-industry firms. Only to the extent that capital is less expensive to conglomerates would we see higher output per labor hour in conglomerates when the economy is at or near a secular equilibrium. In this situation, we would also see lower rates of return in the multi-industry firms.

The data showing larger than normal disparities in valued-added per employee hour in different enterprises, as in 1963, indicate a disequilibrium which could be expected to produce the structural rearrangements of the sort seen in the latter 1960s. A disequilibrium means that resources are not being allocated to their most productive uses. Conglomerates, by moving employees and capital from less to more productive applications (perhaps by simply improving the management of those resources in their current use), contributed to growth and improvements in the level of living.

On average, acquirers improved asset management, provided stockholders of poorly managed firms with an improvement in the value of their holdings, reallocated capital and labor from less to more productive uses, and improved the economic health of the country. They brought us closer to a long-run, efficient equilibrium in the allocation of resources, despite the continuing movement of the equilibrium position.

Chapter 4

Mergers and Conglomerate Power

Some recent arrivals on the Big Fifty list, such as Gulf & Western, International Telephone, and Tenneco, got there by acquiring dozens of diverse firms and divisions sold by other firms. They are conglomerates--or, as they prefer to call themselves, multi-industry or multi-market companies.[1/] Harmful effects purportedly stem from their size. Sinister motives are said to underlie their diversification. Fears that conglomerates will engage in reciprocal arrangements--transactions in which the

conglomerate coerces a seller by saying to him, "I will buy your product only if you buy mine"--are raised. It is also suggested that these multi-marketers use cross-subsidization to grow larger and to dominate markets in which their divisions operate. Presumably, they subsidize predatory activity by some divisions with the profits of other divisions.

The desire to present the conglomerate corporation as a destructive or exploitive economic organism often leads to a Jekyll and Hyde caricature in which the pitiless competitive instincts of one minute are replaced by the collusive, parasitic impulses of the next. Conglomerates might entrench their aquisitions in their markets by predatory cross-subsidization or they might profit from mutual competitive forbearance.

Potential Predatory Pricing

The cross-subsidization argument is another version of the predatory pricing fear. That is, it assumes that one of the divisions of a conglomerate might price below cost, financing this money-losing endeavor with profits earned in other divisions, to drive out competitors. Once it drives competitors from the field, the division could, it is asserted, raise its price to monopoly levels, recouping its losses with interest and more.

Although this possibility has gained adherents in Washington and in the courts--despite the fact that antitrust laws can be applied by the government and that injured competitors can sue for treble damages in such cases--hardly an economist specializing in industrial organization believes that this strategy is feasible or profitable.[2/] Professors Lorie and Halpern observe that, "In the long run, and in the absence of effective barriers to entry, it seems impossible to maintain an effective monopoly by a temporarily superior capacity to lose money."[3/] Professor David Kamerschen tells us that

> I think there is something of a consensus among industrial organization economists that true predation is very unusual, probably illogical, and not a serious social problem in the U.S. The following quotations from respected scholars in this area should suffice to illustrate this consensus: (1) Elzinga . . . "Predatory price cutting, given its unlikely occurrence and visual similarity to healthy business rivalry, should be well down the priority list of the antitrust authorities"; (2) Dewey . . . "From the foregoing remarks, it also follows that predatory price-cutting

> constitutes a minor threat to competition"; (3) Scherer . . . "Distinguishing price cutting with predatory intent from price cutting in good faith to meet tough local competition is singularly difficult . . . It is fair to say that the predatory pricing doctrine is one of shakiest pillars of existing antimerger law. Its absence would not be mourned by lovers of competition and/or logic."; and (4) Scherer . . . "in actual situations the line between meeting competition and destroying it is seldom sharp, since a great deal depends upon intent, which is hard to pin down." The legal profession seems equally outspoken as how threatening a "clog on competition" is predation, arguing that the dangers of predation are few in principle, unlikely in occurrence, and speculative in demonstration.4/

Speaking directly on the issue of the likelihood of predatory pricing as a consequence of conglomerate mergers, Professor Donald Turner, a former head of the Antitrust Division, notes that

> . . . the belief that predatory pricing is a likely consequence of conglomerate size, and hence of conglomerate merger, is wholly unverified by any careful studies; research and analysis suggest that in all likelihood this belief is just wrong.
>
> To sum up predatory pricing seems so improbable a consequence of conglomerate acquisitions that it deserves little weight in formulating antimerger rules based on prospective effects.5/

Even the Federal Trade Commission's Bureau of Economics treated the prospect of cross-subsidized, predatory activity by conglomerates with undisguised skepticism after engaging in a detailed study of conglomerate behavior and performance. In its report on its survey of nine large conglomerates, it states that it found no evidence of predatory behavior nor could it find "any rational incentive for them to do so." It says

> It should be noted that in calculating the returns from a predatory pricing strategy, a time discount factor would have to be applied to the expected monopoly return. The "deep pocket" losses would occur in the present, whereas the monopoly returns would begin at some distant point in the future, perhaps ten years hence. Only when the losses were small or of short duration, or the monopoly profits very large, would such a strategy be economically rational for a conglomerate. In addition, a predatory strategy presumes that there are significant entry barriers in the market where the conglomerate is attempting to eliminate smaller rivals. Otherwise, new firms would enter after prices were raised and the conglomerate would not be able to reap monopoly profits.6/

Similarly, the Presidential Task Force on Productivity and Competition stated that

> There is now an impressive body of literature arguing the improbability that a profit maximizing seller, even one with monopoly power, would or could use below-cost selling to monopolize additional markets. Yet . . . the alleged danger of predatory pricing remains a principal prop of [the FTC] vertical and conglomerate antimerger cases.7/

The unlikelihood of predatory pricing was cogently demonstrated by L. E. Birdzell. The considerations he lists that would have to be taken into account in preparing a business plan for taking over an industry via predatory pricing show that such a plan would be extraordinarily expensive.8/ The improbability of predatory pricing is confirmed by its rarity.9/

The direct evidence on the market share trends of conglomerate acquisitions after merger demonstrates that neither entrenchment nor predatory pricing is a common tactic (or else conglomerates were remarkably inept in their use of predatory pricing).

> [The] post-acquisition changes in market positions acquired by conglomerates from 1963 to 1969 were predominantly decreases. . . . After the massive merger activity of the 1960s, the market share of the conglomerate firm in 1969 was less than 5 percent in 82.4 percent of the five-digit product classes in which they operated.10/

Potential Reciprocity

Reciprocity is an even weaker pillar of antitrust than predatory pricing. Professor Wesley Liebeler suggests that any cartel laying down rules to prevent secret, difficult-to-detect price cuts that cheat on the cartel's price policy would forbid purchases by any member of the cartel from its customers. If such purchases could be made and were allowed, it would be simple for any member to overpay a customer for supplies bought from the customer as a way of secretly shading the cartel price to obtain business.11/

The lower price would not appear on any invoice and inspection of the cartel member's books would show no violation of the cartel agreement. Professor Liebeler goes on to suggest that if the Antitrust Division had stumbled across a reciprocity ban by a price colluding group, it would have become antitrust doctrine to forbid the <u>prevention</u> of reciprocal

purchases. As matters stand, however, the Antitrust Division forbids reciprocal dealing, behaving as an enforcer of cartel arrangements.

Reciprocal dealing is either a procompetitive[12] or innocent practice.[13] In one instance, it was a method of exporting profits from a division where they would be subject to renegotiation on defense contracts to a division where they would be sheltered. There is no case where reciprocity has been an anti-competitive device to our knowledge. It was most extensively used by railroads unable to compete for business by offering a lower rate because of the price floors set by the Interstate Commerce Commission. Given the restrictions on methods of competing, railroads commonly resorted to offering to buy supplies from potential customers if they would purchase the railroad's services.[14] Similarly, other firms wishing to cut prices secretly have engaged in reciprocal deals to disguise a price cut.

Instead of being imposed as a condition for purchase, as usually argued by the antitrust agencies, reciprocal dealing is ordinarily a sales device. A seller offers to buy from his prospective customer to persuade him to purchase. It has the same competitive effect as an offer of generous credit terms, quick delivery, payment of transportation charges, provision of display or shelf stocking service, et cetera.

Secret, discriminatory price cutting works to undermine collusion.[15] It provides a method of competing when the explicit price is fixed. Also, it helps move a competitive industry to a new, long-run, lower-price equilibrium more quickly.[16] Since reciprocal dealing is a way of granting price concessions that would not be granted if such concessions had to be offered openly, it would seem that we should welcome additional possibilities for reciprocal dealing. While this might be a reason for favoring conglomerate mergers, rather than disapproving of them, it turns out that conglomeration evidently does not increase the amount of reciprocal dealing.[17] Modern methods of managing multi-industry firms, with division managers judged by division profit performance, militate against the use of reciprocal dealing by conglomerates to any greater extent than by single industry firms.[18]

Entrenchment and Potential Mutual Forbearance

The "entrenchment" argument against conglomerate acquisitions, used recently by the Antitrust Division in its attempt to stop the merger of Occidental

and Mead, is the opposite of the "competitive forbearance" argument invented by Corwin Edwards. He suggested, without any evidence, that when large firms face each other in many markets, "there is an incentive to live and let live, to cultivate a cooperative spirit, and to recognize priorities of interest in the hope of reciprocal recognition."[19] Yet the Division argued against Occidental Petroleum's acquisition of Mead on the ground that Occidental would entrench Mead's position in the paper industry by expanding its business. Apparently, entrenchment was used in this case as another name for the "deep pockets" argument. Occidental would, said the Division, provide Mead with additional capacity for increasing sales to current customers and for winning additional customers.[20] This hardly smacks of competitive forbearance.[21]

Implicitly, the entrenchment argument suggests that there are advantages to size that will automatically accrue to any large-size company moving into a market. It will acquire an ever-increasing share of that market by taking business from existing firms. If there are such important and uniform advantages of size across industries, we should capitalize on these advantages to the fullest extent by moving large-size corporations into every industry. That would bring the economies of size to sellers with small market shares and keep a larger number of sellers alive in each market and preserve a larger number of competitors in each.

The evidence does not suggest such uniform and automatic advantages in every industry, however. Professor Michael Gort's study of 111 diversified firms showed that these firms continued to occupy only a minor share of most markets many years after entry.[22] The FTC's Bureau of Economics detailed study of nine conglomerates came to the same conclusion. In the language of the report

> Looking at leading positions--market shares over 10 percent--increases and decreases after acquisition were evenly matched. The conclusion to be drawn . . . is that there is no systematic tendency for market shares either to increase or decrease after acquisition. This is true both for "toehold" and for leading positions.[23]

Also, as was pointed out in Chapter 2, the largest firms in many industries have frequently suffered dramatic drops in their share of the markets in which they operate. If a large share of an industry's output or large

size entrenches a company in its leading position, these dramatic decreases in concentration ratios and market shares would not have occurred (see tables 5, 6 and 7).

Conclusion

Section seven of the Clayton Act forbids mergers where the effect "may be substantially to lessen competition, or tend to create a monopoly." In the leading antitrust case in which a conglomerate merger was ruled illegal, the "may" was stretched beyond any reasonable bounds.[24/] Simply because something is possible does not mean it is likely or probable, especially when (1) the actual actions taken are opposite those supposed as possible, and (2) the possible action would be illogical.

In the Procter & Gamble-Clorox merger, the Federal Trade Commission's case rested, in part, on the possible use of P&G's "deep pockets" (its large size relative to the size of other producers of liquid bleach) and the discounts it received for increased use of network television. The latter was irrelevant since only "spot" television was used by P&G, and by Clorox before the merger, to advertise Clorox liquid bleach. Network discounts do not apply to spot commercials. The "deep pockets" argument was equally irrelevant because:

(1) if it paid to engage in predatory activity to obtain a monopoly, Clorox was nearly as capable of undertaking the financing of the activity as P&G (it was more than three times the size of its nearest competitor in the nation and in some regions it was ten times the size of its nearest competitor),[25/]

(2) predatory activity would have been foolish in the liquid bleach industry since entry barriers were non-existent. Any attempt to recoup the losses from predation would have been met with nearly instant entry of new competitors and expansion of existing competitors, of whom there were 200 at the time of the merger and in the subsequent years before the case reached the Supreme Court,

(3) increased advertising and promotion of bleach by P&G financed out of its "deep pockets" did not squeeze out competitors. It created a "coat-tail" effect which <u>increased</u> the sales of Clorox competitors as well as those of Clorox. The increased sales of Clorox competitors were mentioned in the Court's opinion, but the

Court dismissed its relevance on the ground that one could have predicted an opposite result from the merger even though the prediction would be and was wrong. Speculation on possibilites was ruled to outrank logic, probability, and evidence.

In another leading antitrust case in which a conglomerate merger was ruled illegal, Consolidated Foods-Gentry, reciprocity was the primary focus of the attack. But as we have pointed out, reciprocity is not an anticompetitive tactic. It is pro-competitive or innocent in its effect. In this instance, it was "profoundly pro-competitive."[26/] In a nearly duopolized market, the entry of Consolidated Foods by acquisition of one of the two leading firms ended the neglect of product quality, customer service, and distribution by the other leading firm and led to reduced prices.[27/]

The attack on conglomerate mergers apparently has been bottomed on the large size of the acquiring firms and a presumed possible or potential loss of business by competitors (the antitrust doctrine nominally used was the possible effect of a loss of a perceived potential entrant). But size is not illegal and loss of business by less efficient competitors is what competition is intended to accomplish. The antitrust laws are supposed to favor competition, not prevent it. As the Task Force on Competition and Productivity observed

> The large conglomerate enterprise . . ., almost by definition, . . . poses at most a minor threat to competition. . . . If one interprets "elimination of potential competition," "reciprocity," and "foreclosure" as threats to competition, one can always bring and usually win a case against the merger of two large companies, however diverse their activities may be. These are often makeweights. The economic threat to competition from reciprocity (reciprocal buying arrangements) is either small or nonexistent: monopoly power in one commodity is not effectively exploited by manipulating the price of an unrelated commodity.[28/]

We should add Professor James Ferguson's observation that where there are economies of size in a market or an industry, "The only way to maintain the existing number of firms in a small firm industry . . . is to permit every

firm in the industry to merge with a firm in another market."[29] That would bring the economies of size to sellers who are not the leading firms in their markets, keep a larger number of sellers alive in each market, and thus preserve a larger number of competitors in each. Absent such mergers, economies of size will come after a competitive struggle eliminates many sellers and concentrates business in the hands of a few. "Therefore, the FTC reaches exactly the wrong conclusion in attacking these mergers in pursuit of its policy of maintaining existing competitors in these markets."[30]

Chapter 5

Mergers versus De Novo Entry

One of the arguments advanced against allowing large conglomerates to grow larger by acquisitions does not concern itself primarily with size or aggregate concentration. Instead the issue is the desirability of atomistic market structures--a turn back to the arguments against market concentration.[1] The antitrust authorities have been concerned that a conglomerate making an acquisition ceases being a potential competitor when it becomes an actual competitor by acquisition. Their hope, apparently, was that foreclosing diversification by acquisition would lead the would-be acquirer to undertake de novo entry into the same industry by internal expansion (or if by acquisition, then by no more than a "toehold" acquisition). They seemed to believe that the motive for conglomerate mergers is a desire for diversification into specific lines of business.

Why Conglomerate Mergers Occur

The use of this argument simply demonstrates that the antitrust authorities do not know why conglomerate acquisitions occur. Chief among the many reasons for conglomerate mergers--and the best substantiated hypothesis--is that conglomerates take advantage of opportunities to acquire poorly managed assets.[2] (On these, they earn as much as they would be able to make on any other investment. They succeed in making a competitive return on what they invest by managing the assets well.) The FTC's Bureau of Economics examined the earnings record of eighty-five large firms acquired by nine major conglomerates in the 1960s. It found that

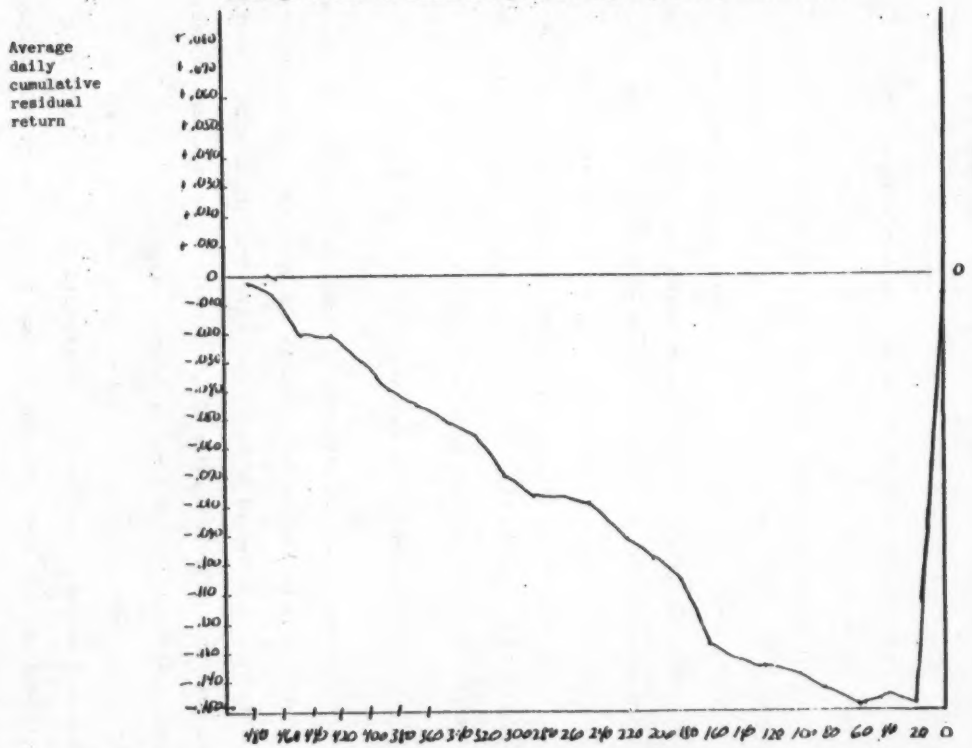
> . . . on the average, the manufacturing firms acquired by the survey firms were significantly less profitable than the average for their industries. . . . The median relative profit rate was 76.5 percent. Thus, the median acquired manufacturing firm was about three-fourths as profitable as the average of other firms in its industry.[3]

The 1955-1976 conglomerate acquisition record, as well as the record of the nine conglomerates studied by the FTC, demonstrates that poorly managed firms predominate among those acquired by merger. Stockholders of the average New York Stock Exchange (NYSE) listed firm acquired in the postwar years lost 15 percent on their investment during the 480 business days preceding the news of the acquisition bid as compared to the returns to stockholders of the average NYSE listed firm (see Figure 3). Acquirers paid a competitive price (the value of the firm in competent hands) for their acquisitions (which provided a premium on the price of the stock of the acquired firms that more than made the stockholders of the acquisitions whole). The acquirers earned a competitive return on their acquisitions (see Figure 2), demonstrating that (1) they managed them better than they were previously managed, and (2) conglomerate takeovers are rational, competitive economic occurrences.[4] Making better use of formerly badly managed assets is a social service. It raises productivity, moderates inflation, and should be allowed to proceed.

This evidence suggests that the motive for conglomerate acquisitions does not usually rise out of a desire to enter a specific industry.[5] The opportunity to acquire poorly managed assets, judging by Professor Paul Asquith's findings in his examination of mergers in the post-World-War-II years, provides the motive for the specific acquisitions made in a majority of cases.[6] The antitrust authorities' "potential entrant" doctrine, however, rests on the

Figure 3

Earnings of Stockholders of Acquired Firms Relative to Average Stockholder Earnings in the 480 Business Days Preceding Acquisition Announcement



Source: Paul Asquith, Mergers and the Market for Acquisitions (dissertation, Graduate School of Business, University of Chicago, 1980).

premise that foreclosing conglomerate acquisitions will force the conglomerator to enter the field of potential acquisition de novo.

It is sometimes argued that the large firms that have become conglomerates did so because their home industries had matured or because they had tax loss carry forwards which would expire unless they acquired profitable firms whose earnings could be sheltered by use of loss carry forwards. While this is true for some conglomerators, it remains that the firms they selected for acquisition were predominantly those which had poor earning experience, not those in industries which the conglomerators were specifically desirous of entering. They may have limited their search to part of the universe of industries, but not to a specific industry which they would have entered de novo or by a toehold acquisition if barred from acquiring the corporations they actually purchased.

The Effect of Conglomerate Mergers on Entry

Conceding the premises of the antitrust doctrine, it still does not follow that mergers by large conglomerate firms should be barred. It can be argued that entry will be decreased by such a bar. The prohibition will be a barrier to entry rather than an encourager of de novo entry. It will decrease entry by conglomerates and it will decrease de novo entry.

If a major portion of conglomerate acquisitions occurs because poor management of assets causes the price of acquired firms to be below their value if well managed, preventing the purchase of these assets will simply decrease the interest of conglomerates in entering the industries where the assets are employed. Stockholders in 93 percent of the firms acquired by conglomerates had inferior returns relative to an average holder of NYSE stocks in the period before the announcement of the merger bid. Eighty percent of all firms acquired by conglomerates suffered relative losses of more than 10 percent. The majority of conglomerate acquisitions evidently consisted of poorly managed firms.[1/]

If the earnings experience of the acquired firms' stockholders is, in part, the consequence of the maturation of the industries in which the firms carry on their business, the industry will not be an attractive one to enter de novo. With sufficient capacity already in place to depress earnings to a level where a firm earning less than the average in its industry suffers relative to the average of firms in all industries, de

novo entry would be a misuse of resources. It would not be attractive since additional capacity placed in such industries would not earn as much, on the average, as alternative investments. It is unrealistic to believe that a conglomerate will try to force its way into an industry, which is unfamiliar territory, with new capacity when there is already sufficient capacity in place to depress average earnings in the industry to the level of the cost of capital.

Some of the acquired firms whose stockholders suffered losses may be in industries in which earnings are attractive, but this is likely to be only a small proportion of such firms. For them to produce relative losses for their stockholders, their managements have to be grossly inadequate. In such a case, the argument for allowing their acquisition by other firms is even more compelling, even at the price of precluding a de novo entry.

The inefficiency of the former management of an acquired firm does not necessarily lie in how poorly it managed production or marketing or employee relations. It may simply have consisted of not knowing enough to stop throwing good money after bad. If a firm's industry was mature or had begun to decline, continuing to invest in such an industry wasted resources. Borrowings from stockholders in the form of retained earnings or depreciation did not earn enough to maintain the value of the firm's assets and caused the value of the shareholders' assets to decline. Nor was this a service to buyers in general who obviously preferred the product of alternative investments. Their unwillingness to buy the products of the firm at a price that would yield as good a return as the product of alternative projects demonstrates this.

In fact, it is on exactly this point that those directing conglomerates have displayed a good management. Examining a sample of firms that engaged in multiple mergers in the 1960s, Professors Weston and Mansinghka found that these firms raised the ratio of earnings before interest and taxes to total assets from 8.7 percent in 1958 (as compared to 16.7 percent in a control sample) to 15.1 percent in 1968 (as compared to 15.6 percent in the control group).[8/] These multiple-merger firms obviously were based in over-expanded industries. Instead of throwing good money after bad, they proceeded to allocate resources to more productive uses than could be found in their home industries. Professor Michael Gort's work analyzing the sources

of growth for the period 1967 to 1977 in the 100 largest non-oil companies confirms the slower growth of the home industries of these firms. If they had not been or become conglomerates and simply grown at the same rates as their home two-digit industries, their share of manufacturing sales and assets would have been below what they actually attained.[9]

A portion of the acquisitions of conglomerates consists of firms whose stockholders have suffered no losses. These cannot be categorized as having been inefficiently managed. It could be argued that there is, in this case, an intent to enter a specific industry or to acquire the facilities of a particular firm. But does it follow that barring the acquisition route would result in de novo entry?

If a potential entrant interested in a specific industry chooses to enter by acquiring an established firm, it will have to offer a price for the firm greater than the present value of the returns expected by the sellers if they retain ownership of the firm. It will offer such a price if it believes that it can manage the acquired assets more efficiently and profitably than they are being managed. There may be management efficiencies as a result of integration or benefits from new or additional management to pursue overlooked or neglected opportunities. Alternatively, the acquiring firm finds it cheaper to enter the industry in this way than by building new assets, a new organization, a new set of business connections, acquiring know-how, and seeking to replicate the locational and resource advantages of the existing firm. If management efficiencies are possible, and such acquisitions are barred, improvements in efficiency are thereby barred. If cheap entry is the reason for the acquisition, blockage of acquisitions may block entry. More expensive methods of entry may mean that the industry will not be worth entering. Professor Jesse Markham found, in his extensive survey of acquiring firms, that the acquiring "companies seldom regard entry by new investment as a feasible alternative to entry by acquisition in particular industries."[10]

In either case, prohibiting entry by acquisition <u>to a firm that might be a potential entrant</u> is likely to block the expansion of capacity that would be undertaken by such a firm or permit the greater decline of capacity likely to occur in a poorly managed firm. Entry consists of expansion of

capacity or maintenance of capacity which would otherwise contract. It is irrelevant whether the expansion is by an acquired firm or by a firm new to an industry. In the case where acquisition is motivated by the opportunity to acquire poorly managed assets, an improvement of efficiency will lower long-run marginal costs and lead to greater output than would otherwise occur. If the entrant is motivated by a desire to enter the industry and is choosing the cheapest method of entry, the would-be entrant evidently sees opportunities for expansion or for improvements in profit not recognized by the acquired firm. It is for this reason that it is willing to offer a price exceeding the value of the firm to its owners.

The Effect of Foreclosing Acquisitions on Innovation

Where a potential entrant sees an opportunity in an industry--perhaps an opportunity to offer a new product or to apply a new technique--it may prefer acquisition of an established firm with a producing organization or established dealer body in order to move the new product into the market or apply its new technique quickly. If it must struggle to build a viable producing and marketing organization from the ground up at the same time that it is trying to develop and establish an innovation, it will find the speed with which it can move its innovation into use slowed.[11/] The consequent slower growth may make the payoff too small and too distant to make the investment in a new product or technique worth the cost. Established competitors will also have a longer time in which to develop competitive new products.

It appears that an organization growing more rapidly than 10 percent a year (as measured by asset growth) finds itself faced with problems that increase costs markedly. This limits the rate of entry (expansion of capacity) and confines the de novo entrant with an innovation to a much lower rate of entry than if it enters by means of an acquisition. The result of foreclosing entry by acquisition could be a slower rate of adoption of innovations and less incentive to innovate.

The Effect on De Novo Entry of a Foreclosure of Acquisitions

Preventing acquisition by major firms because they are potential entrants de novo may reduce the number of de novo entrants. Barring firms from selling their assets to large firms will limit the marketability of those

assets. De novo entrance into a field will be diminished by this reduced marketability. The incentive for entrepreneurs to establish new firms will be reduced and it will be more difficult to obtain financial resources. Reduced marketability of firms increases the risk to those who might provide financial resources for the establishment of such firms and reduces the prospective returns to entrepreneurs. Professors Donald Turner points out that

> . . . to forbid [a category of] mergers . . . would narrow . . . the category of acceptable mergers, thereby drastically weakening the market for capital assets and seriously depreciating the price entrepreneurs could get for their businesses when they wish to liquidate. Such a policy . . . might have adverse effects on entry and growth of small business . . .[12/]

The result of the recent actions of the FTC in the proposed Lancaster Colony acquisition of Federal Glass provides a dramatic example of the losses that can be forced on a firm's stockholders and employees by forbidding the sale of a firm or a division to specific would-be acquirers. Lancaster offered $40 million for Federal Glass in 1977. The FTC acted to stop the acquisition although the Federal Company informed it that the glass division was failing and would be out of business unless Lancaster acquired and operated it. The FTC replied that the Federal Company should find a more acceptable purchaser although its investment banker had solicited offers from eighty firms with no takers. Lancaster indicated to the Federal Company that FTC opposition had cooled its interest, and it withdrew its offer. On February 14, 1978, Federal Company dismissed its 1,500 glass division employees, told its customers it would no longer supply them, shut down the operation, and called in liquidators to dispose of its plant, equipment, and inventories. The FTC eliminated the competitive influence of the company's capacity in the glass tableware market in the name of maintaining competition.[13/]

The fate of Federal Glass and the losses caused by the FTC's antimerger policy illustrate what led Professor Turner to conclude that decreasing the demand for companies by forbidding some class of acquisitions will decrease the birth rate and growth of companies. The usual response to a decrease

in the demand for anything, of course, is a decrease in the rate of supply. Forbidding acquisitions by a class of firms in the name of encouraging de novo entrance, or for any other reason, will decrease the amount of de novo entrance. The number of new firms founded and the number of firms supplied with additional capital to grow to middle size will decrease with the decreased demand for firms. As Commissioner Robert Pitofsky pointed out in the Pillsbury-Fox Deluxe Foods merger decision,

> Long-term competitive considerations require preservation of ease of entry and opportunity for businessmen to take entrepreneurial risks. The other side of that coin is a largely unarticulated policy, a clear corollary to the first, which would preserve exit opportunities where significant anti-competitive results do not occur. It is essential that the owners of very small businesses with slight competitive potential have some reasonable flexibility to sell out.[14/]

The record of the American economy in the 1960s, the period of the "giant" conglomerate merger wave, demonstrates that we need have no fears about the top 200 corporations encompassing the whole of U.S. industry, as some alarmists would have us believe will be the consequence of allowing conglomerate mergers to go unchecked. What is notable about the actual change in the U.S. industrial structure in the 1960s, in contrast to the hypothetical fears, is that the number of corporations did not decline with the great number of mergers and acquisitions (disappearances, in the nomenclature of the merger literature) in that period. The number actually rose from 1,100,000 active corporations in 1960 to 1,600,000 in 1970 (see table 10). There was an increase of more than 40 percent.
There was increasing diversity in American business during the 1960s merger wave.

Table 10

Corporation, Business Enterprise and Entrepreneurial Populations of the United States, 1945-77

Year	Active Corporations	Business Enterprises	Entrepreneurs
	Returns Filed (Thousands)	Number Operating (Thousands)	Individuals With Self-Employment Income (Thousands)
1945	454	NA	7,377
1950	629	7,494[a]	8,988
1955	807	9,046[a]	10,200
1960	1,141	11,172	10,518
1965	1,424	11,416	10,751
1970	1,665	12,001	11,178
1975	2,024	13,979	13,003
1977	2,241	14,740	

Source: U.S. Bureau of the Census, Statistical Abstract of the United States: 1980 (Washington, D.C., U.S. Government Printing Office, 1980), p. 556.

[a]Does not include partnerships. Figure not available.

Even if we confine our view to only the corporations in manufacturing and mining with over $10 million in assets, the same results emerge. There was roughly a 40 percent increase in their number, along with 1,199 acquisitions of firms in this size class, during the decade.

The increasing number of corporations and the increasing diversity of American business are both encouraged by mergers rather than damped by them. When mergers and acquisitions can be consummated with little interference, there is a marketplace for firms, both healthy and failing, which offers owners of firms a fair price for their equities. It is encouraging to a potential investor that, no matter what the course of his business, he can get a fair price for it at any time, instead of having to go through the costly and time consuming process of liquidating assets and paying off debts. Hence, a strong market in mergers and acquisitions acts as a stimulant to entrepreneurship, new investment, and business innovation.

Also, when there is a good market for firms, those who are trying to establish new businesses or expand their firms find capital available and on more convenient terms than would be the case if there were not an active market for businesses. When potential providers of capital know that there is an active market for firms, they are more willing to become actual providers. Their opportunity for gain is greater and the risk of loss is less in an economy that has an active market for businesses. If a firm seeks capital to take advantage of an expanding opportunity, it will find that capital is easier to obtain in these circumstances. If it grows to a size with which its current officers have little experience, the stockholders are not stuck with a management that cannot handle this problem. The firm can be sold to some corporation that has management accustomed to such a scale of operation. That makes capital easier to obtain than if there were a less active market for companies. Because a sellout is possible, potential stockholders and lenders know that they will be able to bail out of an investment that turns sour because of managerial error. Also, the possibility of profiting more quickly in the early development of a product, technology, or market, once its promise is demonstrated, makes investment in innovating activities more attractive. If this route were not open and active, there would be greater reluctance to invest in such companies. These firms would find it difficult to grow, and the rate of increase in the number of corporations and in the number of middle-size firms would decline.

Conclusion

When Senator Metzenbaum claimed that the growth of conglomerate mergers was accompanied by "the disappearance of independent firms and the steady increase in control by fewer and fewer firms,"[15] he simply disregarded history. During the rising merger wave in the 1960s, the number of firms continually increased. "Fewer and fewer firms" was not the direction of the trend in number of non-farm businesses.

The claim that aggregate concentration is increasing as a consequence of conglomerate mergers is equally specious. The usual trend figures cited are those for the share of 200 leading corporations in a sector of the economy whose share is itself shrinking and in which, therefore, aggregate concentration could be expected to increase. Aggregating all

nonfinancial corporations shows a very different trend in the share of leading corporations. But whatever the trend, conglomerate mergers have had such an insignificant influence on aggregate concentration that the effect is hardly detectable. All the mergers of the 1960s do not add to the equal of one IBM, and all those mergers were not with the leading 200.

And the evidence that conglomerate mergers are anti-competitive does not exist. To suppose that conglomerates might engage in predatory pricing, reciprocal dealing, or mutual forbearance is not evidence.

The argument that the number of potential entrants into an industry is reduced or the threat of potential entry removed when a large firm acquires another outside its own field with a consequent lessening of the discipline imposed by possible entry disregards the common experience that any attractive investment opportunity has always been a magnet for many entrepreneurs. If anything, "the buildups in potential competition implicit in the growth of the free-ranging multi-product firm would appear to have pro-competitive effects of a general scope and importance completely offscale in relation to the rather finicky case made for the anti-competitive effects of particular conglomerate mergers."[16/] An anti-acquisition policy would serve only to protect slothful management of existing firms from either a take over or from entry and competition by a newcomer who is likely to disregard any anti-competitive folkways of the trade.

Chapter 6

Aggregate Concentration: A Phenomenon in Search of Significance

Adolf Berle and Gardiner Means, in their 1932 book on The Modern Corporation and Private Property, first gave us the number 200 designating the group of leading corporations that would engulf the wealth of the nation. They told us that the 200 were "growing between two and three times as fast as all other non-financial corporations." They added that it would take only to 1969, at the 1909-29 growth rate of the 200, "for all corporate activity and practically all industrial activity to be absorbed by 200 giant companies."

Berle and Means described this century as a period in which "American industrial property, through the corporate device, was being thrown into a collective hopper wherein the individual owner was steadily being lost in

the creation of a series of huge industrial oligarchies."[1] With the economic concerns of that day, more copies of the book were sold than the ghost stories of Washington Irving. The tract went through ten printings by 1936.

The threat of a takeover by the 200 periodically resurfaces in Congressional hearings, in speeches by attorneys general, and in studies by government agencies and commissions of "megacorporations" and aggregate concentration. Aggregate concentration, as used in many recent discussions, refers to the share of total manufactured output produced by leading manufacturing companies or the share of the nation's manufacturing assets owned by its leading manufacturing corporations. Less frequently, these days, it refers to the share of all nonfinancial corporate assets owned by leading nonfinancial corporations. When the declining trend in the 200's share of all nonfinancial corporate assets became well established (see table 11), this aggregation was dropped from the debate and attention was directed to the manufacturing sector.

Typically the data focus on the top 50 or 100 or 200 firms. The choice of the number of corporations to aggregate is arbitrary. There is no accusation of any specific number acting collusively or even of similar interests among the top 50 or 100. But the intimation is that there is something sinister about 50 or 100 firms turning out a sizeable share of the country's product.

Occasional discussions also crop up of "interests." The Rockefeller or Mellon "interests" are alleged to wield enormous power over the economy through their investments in half a dozen among several hundred large corporations. At other times attention is paid to corporate directors who sit on more than one board.[2]

Concern about these issues is expressed for the most part on what must be termed ideological grounds. Economic analysis offers no case against the growth of aggregate concentration in either manufacturing or in all nonfinancial corporate activity. Few legislative initiatives have been directed against aggregate concentration. The Utility Holding Company Act of 1935 is a major exception. In a recent interview, however, John Shenefield, then chief of the Antitrust Division, recommended legislation to block the acquisition of any other firm by a company with $2 billion or more of sales or assets. His reason:

From the late 1940s until the early 1970s the fraction of manufacturing assets controlled by the 200 largest companies increased from 46 percent to more than 60 percent. He would not want to see the trend continue.[3/]

Table 11

Share of Leading Nonfinancial Corporations of All Nonfinancial Corporate Assets

Year	Percentage Share of All Nonfinancial Corporate Assets	
	Leading 50 corporations	Leading 200 corporations
1929	....	49.4
1933	....	57.0
1958	24.4	41.1
1967	24.5	41.2
1975	23.3	39.5

Source: U.S. National Resources Committee, The Structure of the American Economy, p. 290; William Comanor, "Prepared Statement for the Subcommittee on Antitrust, Monopoly and Business Rights," 1979 S. 600 Hearings.

This approach departs radically from our tradition of judging mergers on the basis of their effect on competition and on efficiency in the use of resources. Occasionally measures of aggregate concentration have been interpreted as indexes of "concentration of economic power." But as Professor Carl Kaysen pointed out in Congressional testimony, such an interpretation

> draws its validity from the association of overall measures with measures of concentration in particular markets, and cannot be given significance as an indicator of the distribution of economic power without consideration of concentration in particular markets.
>
> "Concentration of economic power" indicates some notion of a disproportionate distribution of influence on economic decisions. If [aggregate] concentration . . . is to be a measure of this, there must be a direct connection between the size of a firm or group of firms in relation to the whole economy . . . and

> the range and consequence of its . . . choices. Consideration of what determines the range of choice over which a firm exercizes decisionmaking power shows that there is no such direct relation. The degree of competition in a market [limits] . . . the range of a firm's economic choice.
>
> . . . Some fairly high degree of [market] concentration is a necessary condition for a significant and persistent departure of a market from competitive behavior; it is not a sufficient condition, however, and markets characterized by the dominance in a statistical sense of a few large firms in terms of market share may behave competitvely.4/

Is Aggregate Concentration Increasing?

Whether rising aggregate concentration portends evil or good is an open question. But there is doubt as to whether such a trend exists. William Comanor, chief of the FTC Bureau of Economics, testifying in 1979, reported that

> In 1958, the 50 largest nonfinancial corporations controlled approximately 24.4 percent of all nonfinancial corporate assets; this figure declined slightly to 23.4 percent in 1972 and 23.3 percent by 1975. . . . Similar results appear for the aggregate concentration ratios of the top 200 firms. Concentration declined from 41.1 percent in 1958 to 39.9 percent in 1972 and 39.5 percent in 1975.
>
> . . . The 50 largest nonfinancial corporations accounted for 46.2 percent of corporate after-tax profits in 1958, 36.5 percent in 1972 and 24 percent in 1975. For the 200 largest firms, the corresponding ratios were 73.9 percent in 1958, 55.8 percent in 1972 and 39.2 percent in 1975.5/

Berle and Means reported that "200 big companies [in 1929] controlled 49.2 percent or nearly half of all non-banking corporate wealth."6/ It would appear from these numbers that Shenefield had his trend on backward (see table 11). Shenefield, however, referred to corporate manufacturing assets, which are only a quarter of all corporate assets, not to the larger group of nonfinancial corporations, which include merchandising, utility, mining, construction, and services corporations as well as manufacturing. Since manufacturing is declining in its share of the economy (from 33 percent in 1956 to 24 percent in 1980), we would expect its leading corporations to show a rising share of manufacturing.

In any case, assets are an inappropriate measure of ability to make discretionary decisions as to prices, quality of a product, or wage rates. Share of

sales or production of a specific product in the hands of the leading two to four firms is regarded by economists as a far more appropriate measure, and many of them are doubtful even about the usefulness of that measure.

The Bureau of Census data on domestic manufacturing production show a decline in the share of the 50 largest manufacturing corporations from 28 percent in 1937 to 25 percent in 1977 (see table 12). The 200 largest show a rise

Table 12

Shares of Manufacturing Value-Added and Shipments of the Largest Manufacturing Companies of 1947 and of Each Census Year, 1937-77

	50 Largest Manufacturing Companies			100 Largest Manufacturing Companies			200 Largest Manufacturing Companies	
	Largest in			Largest in			Largest in Census Year	
	1947	Census Year	Census Year	1947	Census Year	Census Year		
	Percentage Share of Manufacturing			Percentage Share of Manufacturing			Percentage Share of Manufacturing	
Year	Value-added		Shipments	Value-added		Shipments	Value-added	Shipments
1937	..	20[a]	28	..	26[a]	34	32[a]	41
1947	17	17	23	23	23	..	30	..
1954	21	23	25	27	30	..	37	..
1958	20	23	..	27	30	..	38	..
1963	21	25	25	28	33	34	41	42
1967	20	25	25	27	33	33	42	43
1972	17	25	24	24	33	32	43	43
1977	19	24	25	25	33	35	44	45

Sources: Bureau of the Census, Concentration Ratios in Manufacturing (May 1981), Tables 1 and 2, p. 9-7 and Table 4, p. 9-9; Concentration Ratios in Manufacturing Industry 1963 (1966), Table 1B, p. 2; W. F. Crowder, A. G. Abramson, and E. W. Staudt, The Product Structure of Large Corporations, in Temporary National Economic Committee, The Structure of Industry (1941), Table 1, p. 583 and 1C, p.715; R. L. Nelson, infra n. a.p. 90; National Resources Committee, The Structure of the American Economy at 272, Table III.

[a]This is a low estimate since it is the value-added share of the largest companies ranked by value of product shipments. R. L. Nelson, Concentration in the Manufacturing Industries of the United States (1963), n. 2, p. 90.

from 41 percent in 1937 to 45 percent in 1977. The fact that the shipments share of the fifty largest firms declined while that of the 200 rose manifests increasing equality of size. This, if size has any significance, reduced the power of the largest firms.

We should also take account of the fact that U.S. manufacturers compete with foreign producers as well as domestic rivals. Michael Gort suggests that "In view of increased imports, if we were measuring the proportion of U.S. sales rather than production of manufactured goods accounted for by the largest 200 firms, the percentage may well have declined."[7] In 1960, we imported goods and services equal to 4.6 percent of total production in the United States. By 1980, imports increased to 12.1 percent of total U.S. production. Since many of these increased imports, such as automobiles, radios, calculators, typewriters, copiers, trucks, and petroleum products are the same goods as those produced by the 200 leading manufacturers, the effect on their share of sales in the United States may well have been the decline suggested as a possibility by Professor Gort.

Professor Jesse Markham, commenting on the views that are held on aggregate concentration and on the effect of the conglomerate merger wave that crested in the late 1960s, observed that

> One of the most popular views on the American economy is that it is dominated by a relatively small number of giant corporations, and this dominance increases with each passing year—largely through merger. This view is uncritically accepted and widely disseminated by authors of the nonprofessional literature on the subject. FTC reports on mergers and industrial concentration often draw this conclusion.[8]

Even if the leading 200 industrials were actually to use 60 percent of the corporate assets employed in domestic manufacturing, their share of the tangible assets of the nation would be about 3 percent. Corporate manufacturing assets are approximately one quarter of all business assets and one twentieth of all material assets. The other nineteen twentieths of all assets, excluding human capital (accumulated investments in education and training) whose total dwarfs all tangible assets, are held by mining and construction firms, public utilities, farmers, transportation, communication, forestry, fishery, wholesaling, retailing, and real estate firms, philanthropic institutions, governments, and individuals.[9] The assets held by the federal

government (excluding military assets) amount to more than the total for the leading 200 industrials.

Some Causes of the Aggregate Manufacturing Concentration Trend

If we aggregate the assets of the 200 leading manufacturing corporations, the resulting figure cannot be compared to all manufacturing assets in the United States. An important portion of the assets of the 200 are not in the United States; it consists of investments in foreign subsidiaries. These are a larger part of the assets of leading corporations than of other manufacturers. Part of the upward trend that alarmed the former Antitrust Division head was the result of growing investment abroad. This did not increase the leaders' shares of domestic assets or their alleged "control" of the domestic economy.

In addition, if RCA acquires a car rental firm or General Electric acquires a mining company (a major part of whose assets are located in other countries), these are counted as a growth in manufacturing assets held by the 200 because GE and RCA are classified as manufacturing companies. Since 24.7 percent of the employees of the largest 200 manufacturing firms worked in nonmanufacturing establishments (mines, public warehouses, wholesale, retail, and service establishments) in 1963, it is probable that over 20 percent of their assets were outside the manufacturing industries.[10/] General Telephone and Electronics, classed by the FTC as a manufacturing corporation in its compilation of the assets of the leading 200 manufacturers, had $5 billion of assets in the telephone industry. GATX, also classed as a manufacturing corporation among the leading 200 corporations by the FTC, had assets consisting largely of railroad cars, which it leased to the railroad industry. It also owned a bank. Its manufacturing assets would not place it among the top 200 firms.[11/]

If nonmanufacturing and foreign assets of all firms were stripped from corporate manufacturing asset data, and a fraction with a consistent numerator and denominator computed, the proportion of domestic manufacturing assets held by the largest corporation would look very different. Professor Scherer calculated that the largest 100 manufacturing firms had 36 percent of domestic manufacturing assets in 1963.[12/] The FTC figure for that year without this correction is 46.5 percent.[13/]

We get a more accurate picture of aggregate concentration trends in manufacturing by using domestically manufactured shipments of leading firms as a proportion of all domestically manufactured shipments. First, this uses consistent definitions and is not susceptible to the criticisms mentioned above. Second, leading firms are more capital intensive than other firms, using more assets per dollar of sales or dollar of value-added (see table 13). The use of asset figures overstates the relative position of the products of these firms in the nation's markets.

The shipments share of leading firms dropped from the mid-thirties to 1947, then rose from 1947 to 1954. The trend has been flat since 1954. The leading fifty firms produced 28 percent of manufactured goods in 1937, dropped

Table 13

Assets/Sales Ratio for the Largest and for All Manufacturing Corporations, 1947-67

Assets/Sales Ratio[a]	50 Largest	100 Largest	200 Largest	All Corporations
Ratio in absolute terms				
For largest corporations in terms of assets in each year				
1947	.88	.86	.82	.60
1958	1.04	1.01	.96	.74
1967	1.02	.96	.92	.76
For largest corporations in terms of sales in each year				
1947	.80	.78	.76	.60
1958	.87	.89	.87	.74
1967	.89	.93	.89	.76

Source: Betty Bock and Jack Farkas, Relative Growth of the "Largest" Manufacturing Corporations, 1947-1971 (New York: The Conference Board, 1972), p. 13.

[a]The figures in this table are for the 50, 100, and 200 largest manufacturing corporations ranked in terms of total assets and in terms of sales, respectively, in each specified year.

to 23 percent in 1947, rose to 25 percent in 1954, and remained at that level in the twenty-three following years (table 12), although the composition of the Big Fifty changed considerably. The only thing alarming about this behavior of the share of manufactured output of the largest fifty firms is its failure to rise since the largest firms use labor more productivity than smaller firms.

The share of the 100 largest industrials was the same in 1937 and 1963 and has increased by one point since 1963. The 200 largest share of domestic manufacturing shipments increased by one percentage point between 1937 and 1963, another percentage point between 1963 and 1967, and by two points since 1967. These data present a picture of industrial structure trends that is at odds with the views presented in the 1970s by the officials of the antitrust agencies. They are the relevant data for understanding the place of large firms in domestic manufacturing. The frequently used mixture of foreign and domestic manufacturing and nonmanufacturing assets is irrelevant and misleading.

Even the character of the data on domestic shipments must be closely analyzed to understand what any trend in shares means. Changes in the relative position of various industries occupied by leading firms, for reasons having little to do with their own activities, cause fluctuations in their share of total manufacturing activity. The automobile firms, which ranked numbers 1, 3, 10, and 110 in 1977, occupy a cyclical industry. Since a small recession occurred in 1967, and 1972 marked only the second year of a recovery, their sales were lower in those years relative to total sales than they were in 1977, the third year of recovery from a recession. Also, eighteen petroleum refiners are among the fifty. The rise in their raw material costs stemming from the restrictive activities of the Organization of Petroleum Exporting Countries (OPEC) and the consequent rise in the prices of petroleum products caused a large rise in the revenues of these companies (but not in their relative profitability[14]). This increased the shipments share of the top fifty firms between 1972 and 1977 even as their value-added share declined. The disproportionately heavy representation of automobile, metal, and appliance firms among the top corporations has a cyclical impact on their share, and the large contingent of oil

companies causes events in that industry to be given a major influence in the measurement of shipment shares.

The trend in shares of value-added for the leading 50, 100, and 200 domestic manufacturing firms shows a stronger rise from 1947, which was a low point, than share of shipments data. But value-added too tends to mislead as much as to enlighten. The domestic value-added share of leading firms dropped from 1937 to 1947. It then rose strongly from 1947 to 1954. There was a much slighter rise from 1954 to 1963 with a flat trend since 1963 for the leading 50 and 100 firms. The second 100 added one percentage point to their share from 1963 to 1967 and two more from 1967 to 1977. The smaller firms among the top 200 grew faster than the larger firms.

After the 1937 to 1947 drop in leading firm share of value-added, the majority of the subsequent upward trend resulted from increasing fabrication of product by leading corporations (an increase in the ratio of value-added to shipments), not from an increasing proportion of manufacturing shipments. The value-added share rise resulted, in part, from the ratio rising in the thirty-five companies of 1947 that remained in the top 50 in 1954. (Their ratio of value-added to shipments rose from 0.35 to 0.40). It was also a result of the replacement by 1954 of fifteen companies in the 1947 top fifty by companies whose ratio of value-added to shipments was much higher (0.48 versus 0.29).[15/]

The rise in the ratio of value-added to shipments in the largest 50, 100, and 200 industrials, which played a major role in their early increases in share of manufacturing value-added, can be ascribed in part to decreasing amounts of material used per dollar's worth of product. With improving technology, fabrication increasingly replaced raw material. By this means materials were conserved. As transistors replaced vacuum tubes and integrated circuits replaced transistors and wired circuits, for example, the material required for any given output of electronic equipment dropped. The ratio of value-added to the value of materials increased, as did the ratio of value-added to the value of shipments. Also, the relatively greater growth of more vertically integrated firms, which displaced some of the original top firms, played a role in the increase in value-added relative to shipments. Assembly operations formerly fed by purchased parts began using internally produced sub-assemblies. Parts suppliers began using the parts they fabricated to

make their own final products. Chrysler purchased Briggs Manufacturing, its supplier of bodies, and oil refiners began processing the raw materials they produced into chemicals.

This trend was simply a move toward the average degree of internal fabrication found among other firms. In 1937, the largest fifty firms produced only 20 percent of value-added in all manufacturing although they shipped 28 percent of all manufactured product. They did less fabricating work on the products they shipped than the average manufacturing firm. By 1972, the largest fifty were more like other manufacturers in their vertical integration. Value-added and shipment proportions became more nearly equal. A rise in their share of value-added and a drop in their share of product shipped (table 12) brought about the equality.

The effect of mergers on aggregate concentration has been minuscule. Professor Markham examined the trend in aggregate share between 1963 and 1970 of the largest 50 and 100 industrials. This was the period in which some emerging conglomerates, such as Ling-Temco-Voight and Gulf & Western, moved into the top fifty. He concluded that, "Since no increase in concentration occurred in the period of the conglomerate merger wave, the large volume of acquisitions in the 1960s appears to have left the overall structure of the manufacturing economy unaltered."[16/] To this, Professors Lorie and Halpern, writing in late 1969, add the following comment:

> Between 1960 and 1968, 909 firms in manufacturing and mining acquired other firms with assets of more than $10 million. The aggregate value of the assets acquired was $40.6 billion, an amount equal to the market value of the common stock of International Business Machines Corporation on September 22, 1969.[17/]

The 50 or 100 largest industrial companies is not an unchanging group, each fixed in its position with enduring ties to the rest. Of the fifty largest manufacturing firms in 1947, only twenty-four remained in the top fifty in 1977. Seventeen of the fifty largest in 1977 came from outside the ranks of the 100 largest in 1947. Thirteen of the fifty largest in 1947 no longer appear among the top 100.

The reasons for such changes are straightforward. Each leading firm must work hard constantly to improve its products, keep its prices attractive, raise its productivity, adapt itself to the changing desires of American

consumers, and compete effectively for labor, materials, and capital in order to stay solvent. If its major products become obsolete, it will have to change industries or join United States Leather (no. 7 in 1909) or American Woolen Co. (no. 21 in 1909) in the corporate graveyard. The only real power that large firms have lies in their ability to produce products at a low enough cost to offer wage rates and profits that are attractive to workers and suppliers of capital, and attractive products at prices low enough to entice buyers to choose their goods rather than those of their competitors. Essentially, any member of the top fifty is there because it uses the resources it employs more productively than other companies can use those resources. If it did not, they would be bid away by other firms.

That the fifty employ people more productively than smaller firms is shown by the fact that they produced 24 percent of all value-added by manufacture and 25 percent of all product shipped in 1977 with only 12 percent of the workers employed in manufacturing. The wage paid per worker in the fifty averaged 53 percent more than the wage paid in other manufacturing firms (see table 14). Those who would stop the relative growth of the largest industrials seek, in effect, to foreclose growth in the opportunity for high wage employment. They would slow growth in productivity and speed the relative decline of the United States in the world economy.

Table 14

Shares of Manufacturing Employment and Earnings Provided by the Largest Manufacturing Companies, 1937-77

Year	50 Largest Manufacturing Companies			100 Largest Manufacturing Companies			200 Largest Manufacturing Companies		
	Percentage Share of Manufacturing Production Worker Employment	Percentage Share of Manufacturing Payroll	Ratio of Payroll per Production Worker in 50 Largest to Rest of Manufacturing	Percentage Share of Manufacturing Production Worker Employment	Percentage Share of Manufacturing Payroll	Ratio of Payroll per Production Worker in 100 Largest to Rest of Manufacturing	Percentage Share of Manufacturing Production Worker Employment	Percentage Share of Manufacturing Payroll	Ratio of Payroll per Production Worker in 200 Largest to Rest of Manufacturing
1937	16.2	21.3	1.40	20.8	26.6	1.38	26.3	32.9	1.37
1963	17.2	21.9	1.35	23.1	28.8	1.35	28.9	35.6	1.36
1967	17.9	22.5	1.33	23.6	29.2	1.34	30.7	36.8	1.31
1972	17.9	23.6	1.42	24.0	30.5	1.39	32 5	39.6	1.36
1977	16.8	23.6	1.53	23.6	31.4	1.48	31.8	40.4	1.45

Sources: Bureau of the Census, Concentration Ratios in Manufacturing (May 1981), Table 4, p. 9-9; Concentration Ratios in Manufacturing Industry 1963 (1966), Table 1B, p. 2; W. F. Crowder, A. G. Abramson, and E. W. Staudt, The Product Structure of Large Corporations, in Temporary National Economic Committee, The Structure of Industry (1941), Tables 1, p. 583 and IC, p. 715.

Chapter 7

The Economic and Political Power of the 200

Aggregate or macro-concentration cuts across individual product markets and depends upon the relative size of the largest firms. It is a meaningless concept in economic terms. The fact that a firm ranks among the top 200 does not mean that it can exercise control over its product markets; nor does the rank mean that the firm can depress the price of some input that it uses. Exxon, for example, which produces and sells world wide, receives 73 percent of its revenues from its production and sales abroad. It has been ranked first or second in size by assets or sales among all American manufacturing firms for many years, yet its place is small in the domestic petroleum products industry. It has no market power in refined petroleum products nor can it control the prices of its raw materials. Its share of American manufacturing sales or assets is usually overstated by including its foreign sales or assets in the numerator of the ratio. It might not be at the top of the list if companies were ranked by domestic assets or revenues.

Nor is Exxon a very large firm in the U.S. market relative to other leading oil refiners operating in the United States. It produces only 9 percent of all domestically refined petroleum products. While that makes it the leading firm in its industry, even the market-concentration doctrine implies that such a small share leaves it bereft of any power. If it were to restrict output and attempt to raise its price relative to costs, its postion in the market would fade quickly. Any supply vacuum would be filled by the dozens of other refiners (seventeen of whom are among the fifty leading industrial firms) eager for more business and by importers of petroleum products, assuming government controls would not prevent this. If Exxon even failed to increase its productivity constantly, it would find itself unable to pay wages high enough to hold its workers or offer returns attractive enough to obtain the capital needed to maintain its position in the industry. Its power to do anything--even to produce depends on its ability to serve consumers well at competitive prices. It moved into first place in the retail gasoline market in the United States in late 1979 only because it received crude oil from Saudi Arabia priced about $5.00 per barrel below world market levels. That enabled it to offer gasoline at attractive prices and in larger amounts relative to the supplies available from other refiners.

The Economic Power of "Dominant" Firms

The 1927 shutdown of the Ford Motor Company dramatically illustrates how little influence a "megacorporation" has even when it is large relative to its own industry. Ford was one of the giant firms of the 1920s (and is still America's sixth largest industrial firm although no longer number one in the automobile industry). It produced 60 percent of all automobiles turned out in the United States in 1921. From 1921 to 1925 it supplied as many automobiles as all other companies combined. Ford was a "dominant" firm.

In 1927, it completely shut off its supply to the market for nearly the entire year. It closed down in January to retool for the change from the Model T to the Model A, resuming sales in December. If supplying a majority or near majority of a market gives a firm any power to control supply and price, then the complete withdrawal of that firm's supply would certainly cause a rise in price. Yet, despite its "dominant" producer position, automobile prices failed to rise when Ford shut down. Other manufacturers quickly increased their output. As a result, prices not only failed to rise--they fell by mid-1927 despite the complete withdrawal of Ford from the new car market.[1/]

The story of The American Sugar Refining Company demonstrates the inability of a firm to long influence a price even with 98 percent of the capacity for supplying a market. It was one of the very largest industrial enterprises in the United States in the 1890s, and was still the eighth largest in 1901. At the end of 1891 it encompassed by merger 98 percent of its industry's capacity east of the Rockies. Yet what power it acquired disappeared after it raised prices by 5 percent in 1892 and 1893. By 1894, it lost one-fifth of its market (see table 5) and prices returned to their 1891 level. Similarly, American Can was a leader in size among all industrial and mining firms in 1901 and was still the twentieth largest in 1909 after losing one third of its market share. It too found its dominant position withered when it attempted to raise prices relative to costs(see table 5).

If American Sugar or American Can could not long influence prices starting from positions with 98 and 90 percent of their industry's capacity, it matters little that they ranked among the fifty largest industrial firms at the time of their attempts. It matters even less that Exxon ranks number

one among all manufacturing firms since its market position is vastly less important in its industry than was that of Ford, American Sugar, or American Can. The fact that Chrysler was the tenth largest among all industrial corporations in the United States did not keep it from being a troubled company. Only the most naive observer could possibly tell its president that he controls his output, produces what he pleases, names his price, and compels his customers to buy with advertising. Such news--if it were true--would certainly be welcome at Chrysler Corporation.

Bigness and Political Power

The final argument of those who are concerned about aggregate concentration is that bigness is a threat to democracy because of the political power of the giant corporation.[2/] Since there are no adequate, systematic studies of the political power possessed by "megacorporations," we have only a few observations to report.[3/]

Professor Edward Banfield investigated business power in the city of Chicago. He concluded that business had essentially no power "except by main force of being right."[4/] Professor Edward Epstein suggests that corporations are too reticent in the political process and should press their legitimate interests more vigorously than they do.[5/]

Among the ten largest industrial corporations in America are six international oil companies. If firms among the largest fifty possess any political power, then the six international oil companies in the top ten must have overwhelming "clout." Yet they were the losers from 1960 to 1973 under the mandatory oil import quota program (see table 15). They were losers again after 1973 under the oil "entitlements" and allocation programs. Douglas Bohi and Milton Russell, discussing the "interests" served by U.S. oil import policy, report that:

> The major large group which <u>paid</u> for the benefits of the greater energy security achieved under oil import controls was the undifferentiated portion of the consuming public. With one possible exception, other identifiable functional groups were either unaffected, or actually made better off.

Table 15

IMPORT QUOTAS OF REFINERIES AS PERCENT OF DAILY INPUT OF PETROLEUM (DISTRICTS I – IV, JULY 1, 1959 – DEC. 31, 1959)

SIZE OF REFINERY (THOUSANDS OF BARRELS)	PERCENT QUOTA
0–10	11.4
10–20	10.4
20–30	9.5
30–60	8.5
60–100	7.8
100–150	6.6
150–200	5.7
200–300	4.7
300 AND OVER	3.8

SOURCE: HEARING, SELECT COMMITTEE ON SMALL BUSINESS, U. S. CONGRESS, 86th CONG., 2nd SESS., AUG. 10 AND 11, 1964, [12] P. 121.

> The "possible exception" is the international operations of major oil companies . . . The overall restriction on imports lowered their potential market, and its administration forced them to share the already limited market with newcomers. The special provisions further eroded their position. The sliding scale [which provided smaller refiners with special quota allocations and a relatively larger share of import "tickets"] , the petrochemical quota, the Islands program, the resid program, and the overriding fact that traditional importers were required to share the quota with inland refiners all reduced the advantage of [having developed] overseas production. Virtually every controversy was resolved against the best interests of the original major company importers, a fact with important implications when the political economy of oil is examined. The political power of oil may be great, but based on the record of the mandatory quota program, the power is not found in the international giants of the industry.6/

Professor George Stigler, generalizing from the nation's experience with regulation in many industries, concluded that

> . . . the distribution of control of the industry among the firms in the industry is changed [by regulation]. In an unregulated industry each firm's influence upon price and output is proportional to its share of industry output (at least in a simple arithmetic sense of direct capacity to change output). . . . [P]olitical decisions take account . . . of the political strength of the various firms, so small firms have a larger influence than they would possess in an unregulated industry. Thus, when quotas are given to firms, the small firms will almost always receive larger quotas than cost-minimizing practices would allow. The original quotas under the oil import quota system . . . illustrate this practice (Table 14). The smallest refiners were given a quota of 11.4 percent of their daily consumption of oil, and the percentage dropped as refinery size rose. The pattern of regressive benefits is characteristic of public controls in industries with numerous firms.7/

Among the 200 largest industrial firms are eight pharmaceutical companies. It is enlightening to compare their political power with that of the owners of drugstores. When the Kefauver Committee investigated the pricing of drugs, the pharmaceutical corporations were treated harshly. Since the prices received by pharmaceutical manufacturers are only 48 percent of the retail prices paid by consumers, it was suggested that the Committee investigate the other 52 percent. Within a few hours after the investigation was contemplated, the suggestion was dropped. The force behind this was the power of the National Druggists Association and the American Pharmacists Association. They had far more political power than the eight members of the 200 club.

Professor Richard Posner, examining special interest legislation, concluded that large corporations have no more influence in the political process, actually probably less, than small firms.

> The fact that a great deal of legislation appears to be designed to protect firms against competition . . . provides the basis for a serious criticism of our political system and, perhaps, more broadly, of the role which we allow "interest groups" to play in shaping public policy. It does not suggest a basis for a criticism of large corporations as such. The subordination of consumer to producer interests in the production of legislation seems quite independent of the size of the individual firms involved. We observe as much protective legislation in small business industries, such as agriculture, textiles, and trucking, as in large--perhaps more. We observe much protective legislation in industries where production is carried on by individuals rather than by firms--unionized trades [barbering, plumbing, pharmacy] and regulated professions such as medicine are important examples.8/

The agricultural interests, labor unions, and environmentalists have more than held their own with the 200 in contests for political influence. The tax structure indicates a complete lack of political influence among the 200.9/ There is, for example, heavier taxation of medium and large corporations than of the very small, a depletion allowance provided for the small and medium size oil producers but not for the majors, and double taxation of corporate earnings both as earnings and again as dividends or capital gains (the latter being largely fictitious as a result of inflation10/ while noncorporate firms or small closely held corporations are taxed only once.

In contests with the National Highway Traffic Safety Administration, the three major automotive firms, who were among the ten largest industrial

firms, and International Harvester, a major producer of trucks and number twenty-seven on the list of largest industrial companies, have lost along with their customers and the cause of highway safety. The lack of political power was demonstrated in their unsuccessful attempts to prevent the compulsory installation of antilock brakes on large trucks before they had been developed to the point where they would not be hazardous. Despite the "main force of being right," the four large truck manufacturers, who are among the top fifty industrials, did not prevail with the administration, although electronic antilock brakes had been shown to reduce highway safety. Only the subsequent slaughter, after the compulsory installation of these brakes, finally led a federal court to order the cancellation of the requirement.

In contrast to the impotence of the biggest of the Big 200, the little firms that compose the nuts, bolts, and screws industry forced President Carter to reverse his position on tariff protection for the industry. As the New York Times put the mater, "The $1-billion-a-year industry . . . has powerful friends in Congress who protested when the President came down last February [1978] against a recommendation by the Government's International Trade Commission for protection."11/

L. E. Birdzell has provided a succinct description of the power of the 200 largest industrial corporations.

> The argument that conglomerates represent a political power threat is . . . difficult to take seriously. A large concentration of wealth undoubtedly has a substantial political capability if it can lawfully be applied to political purposes, as illustrated by the successful political use of the Rockefeller and Kennedy fortunes. The fatal problem with similar political use of corporate concentrations of wealth is that they cannot lawfully be applied to political uses, even if stockholders could be induced to agree on common political objectives and the business organization could survive the necessary diversion of effort. Salaried corporate managers are probably not as rich a potential source of political contributions as oil lessors, owners of automobile dealerships, and other entrepreneurs with substantial personal fortunes. And corporate management is rarely able to deliver the votes even of corporate stockholders, let alone employees, dealers, or suppliers. The Automobile Dealers Day-in-Court Act is eloquent testimony to the comparative political power of some very large corporations on the one hand and a group of "small" businessmen on the other.27/

And we can again turn to Professor Posner to add his observations of the political power possessed by large firms, whether large because they are

the biggest in their industries and their industries are large or because they have operations in many different industries.

> That the condition of being a large firm is not itself sufficient to assure protective legislation is illustrated by the embattled condition of the conglomerate corporations. These very large firms were not able to ward off highly adverse accounting [requirements] and antitrust developments . . . .
>
> The conglomerates occupy much the same place in public rhetoric today over corporate abuse that the great monopolies of the turn of the century, such as Standard Oil, occupied in the muckraking journalism of their day. The political power of both groups proved to be weak, or at most transient. The trusts were dismembered, and the conglomerates have been buffeted from a variety of directions without obtaining any succor from the legislative branch. . . .
>
> . . . there appears to be an abiding public need to believe in the existence of invisible, global, omnipotent, indescribably sinister forces--Satan, Freemasonry, Papism, the Jews, and now the multinational corporations. The last satisfies the traditional requirements of a Sinister Force--worldwide in scope, mysterious in its modes of exerting influence, huge and monied. The multinational corporation, and its domestic cousin the conglomerate, have enabled the critics of business and the market economy to invoke and exploit the primitive emotional needs that unite us to our ancestors whom we deride for their superstitions.13/

Conclusion

Politicians seldom pick on labor unions, some of which exercise monopoly power on a scale undreamed of by any corporation, or on farmers. These groups possess political power that not only makes them nearly invulnerable to attack, but also enables them to manipulate the political process in ways and to an extent that would make Thomas Jefferson shudder. Yet it is large corporations that are accused of threatening any Jeffersonian character left in our democracy.14/ The fact that they are so frequently picked as "whipping boys" by politicians demonstrates how little political power they have.

The crusade against the growth of the top 100 or 200 industrial firms and against conglomerate acquisitions is bottomed on specious fears and a mythical trend in aggregate concentration. They provide convenient targets on which to vent anger over rising prices of petroleum products or inflation. If this were simply a harmless and entertaining political game, there would be no need for concern--but it is not.

If we continue to obstruct the growth of large firms and to thwart acquisitions by large conglomerates, we will be foreclosing opportunities to workers for high paying employment, to stockholders for rescue by acquisition from the dissipation of their assets by inept managements, and to the country for enhanced productivity that large firms can bring about. The United States is falling behind the rest of the industrial world in its productivity growth.[15/] It once led--in the period in which the growth of U.S. corporations created some of the world's largest firms.

Chapter 8

CONCLUSION

The legislators who wrote our antimerger laws and supported their passage aimed at preventing restrictions on output. They did not design them to preserve the continuance or independence of inefficient firms, whether large or small. The 1890 Sherman Act outlawed "every . . . combination . . . in restraint of trade." Section seven of the Clayton Act, as amended in 1950, forbade mergers "where the effect of such acquisition may be substantially to lessen competition." Lessening competition is synonymous with lessening output, since to compete less means offering less product to compete for the buyer's dollar.

In the debate on the 1950 amendment, the immediate concern was with what Congress had been told by the FTC was a rising tide of concentration. But concentration in itself was not what was feared. It was thought that high concentration, that is, most sales of a product being made by a very small number of companies, would result in restricted output and high prices to consumers. One of the bill's supporters quoted the FTC Report on the Merger Movement, saying "under competitive capitalism consumers are protected from high prices by the constant rivalry among numerous firms for a greater share of the market."[1/]

Since neither conglomerate nor vertical mergers decrease the number of firms competing with each other, it would seem that it is only horizontal mergers that fall under the strictures of section seven of the Clayton Act or section one of the Sherman Act. Professor James Ferguson argues that if economies come from large size as such--economies in the purchase of advertising, of capital, and of staff functions such as legal and accounting

services, all of which are inputs in the production and marketing of a variety of products—then these economies can be realized by conglomerates without increasing the market shares of individual brands of products. Allowing conglomerate mergers is a way of realizing many of the economies of scale (size), then, without decreasing the number of firms competing with each other in any given market.[2] It is a way of minimizing the power of a corporation without sacrificing the economies of size. We can have our cake (of economies of scale) and eat it too (low concentration in markets) by a policy of encouraging conglomerate mergers.

Should Horizontal Mergers be Restrained

Whether conglomerate mergers should be encouraged and horizontal mergers discouraged may, however, be best left to the market. There may be some circumstances in which most economies of size can be realized by one route and other circumstances in which greater economies can be realized by the alternative route to large size. No blanket policy fits the varied circumstances of different markets, different technologies, different supplies of inputs, or differing levels and types of management competence.

In some markets and industries, small size may be more efficient than large size. If those markets are concentrated by mergers, they are soon deconcentrated by competition. Or if small relative size becomes more economic in a market in which large size was formerly more efficient, competition soon deconcentrates the industry. Markets remain concentrated only if that is the structure that yields the most efficiency.[3]

But we still face the question of whether a few firms dominating a market might cause high prices through a lack of sufficient competition. What is the number of firms required to maintain the competition that will yield the lowest prices to consumers? Trying to maintain too many firms in a market can cause high prices.[4] With the maintenance of an overly large number of businesses in an industry, we lose the economies of scale or the benefits of markedly superior management, when the number of such management teams is small in an industry, or the benefits of innovation in those cases where only a few firms in an industry constantly lead the innovation parade (which soon leads to high concentration if the benefits are passed on).

It can be argued that these benefits will come from internal expansion even when mergers are blocked. But will internal expansion provide those benefits as rapidly? Will capital be wasted and stability be sacrificed by driving the less efficient or the less innovative or the under optimum scale firms into bankruptcy on the road to an efficient industrial structure when the merger path is closed by a strict antimerger policy?

From the evidence available, it does not take many competitors to cause economies of scale or size to be passed on to buyers. The evidence also points to the fact that those industries that are highly concentrated or that become more concentrated tend to reduce costs more rapidly than those less concentrated. As a result, their prices rise less rapidly than those less concentrated. This is exemplified by the 1900-1925 experience shown in Figure 2. Where major consolidations occurred, prices first fell while those industries with no consolidations had rising prices. In the later inflationary period, prices in the former group of industries rose only half as rapidly as those in the latter.

The postwar experience exhibits a similar pattern. In the more than 50 percent concentrated industries, prices rose by only 93 percent of the average rise in all prices.[5/] Another study shows prices declined from 1958 to 1966 in those industries which were more than 75 percent concentrated while prices in less concentrated industries rose.[6/] The bromine industry provides a dramatic example of price decline as the industry went from high concentration to very high concentration. From 1958 to 1979, prices in constant dollars fell by 60 percent as four-firm concentration rose from 80 to 95 percent.[7/] Judging from these experiences, and those of major consolidations which tried raising prices, such as American Sugar and American Can where prices fell back to competitive levels when their shares fell back to 75 and 60 percent (from 98 and 90 percent) respectively, mergers which put together as much as 50 percent of an industry's capacity will not have a price raising effect as long as there are at least two major competitors or open entry.[8/] In the case of United Shoe Machinery, another consolidation, one minor competitor was sufficient to keep its prices at the competitive level.[9/]

In the Alcoa case (1945) the Court ruled that Alcoa had violated the antitrust laws solely by virtue of its large market share and its expansion of capacity to maintain its position. With that precedent and the Celler-Kefauver 1950 amendment to the Clayton Act, mergers that increased concentration or that could be called the beginning of an incipient trend toward concentration, however speculative the possibility of the trend, were condemned by the Court up to the time of the General Dynamics decision (1974). In the General Dynamics litigation, in which the government contended that the merger of General Dynamics subsidiary, United Electric Coal, with the Freeman Coal Company was illegal simply on the basis that concentration was increased by the merger, the Court held that statistical data are "not conclusive indicators of anticompetitive effects." The Court went on to say that "only a further examination of the particular market--its structure, history, and probable future--can provide the appropriate setting for judging the probable anticompetitive effect of the merger.

The Court shifted ground from possibilities to reality. This should be recognized in the new guidelines now being formulated. The old guidelines assume that structure determines conduct and performance. But the reality is that conduct and performance are more likely to determine structure, and that structure will be forced by the market in the direction dictated by efficiency absent governmental intervention. Mergers are largely a consequence of market pressures, the existence of this road to greater efficiency, and the merger route being a more efficient path to the achievement of greater efficiency than internal expansion. Where mergers do not result in greater efficiency, they are mistakes which are costly to the merger makers.

An examination by Professor Bjorn Eckbo of 259 horizontal and vertical mergers in mining and manufacturing industries, of which 183 were challenged by the government, concluded that the mergers were not motivated by monopolizing intentions. The Antitrust Division and the Federal Trade Commission had simply blocked the efficient road to greater efficiency. Eckbo summarizes his findings in the following words:

> This paper tests the hypothesis that horizontal mergers generate positive abnormal returns to stock-

> holders of the bidder and target firms because they increase the probability of successful collusion among rival producers [or achievement of market power]. Under the collusion [or market power] hypothesis, the rivals of merging firms should benefit from the merger since succesful collusion [or use of market power] limits output and raises product prices. This simple proposition is tested on a large sample of horizontal mergers . . . While we find that the antitrust law enforcement agencies systematically select relatively profitable mergers for prosecution, there is no evidence indicating that the mergers were expected to have . . . anti-competitive effects. Since the data also indicate that the enforcement agencies . . . impose costs on defendant firms, we conclude that past antitrust policy has distorted resource allocation by making some efficient mergers unprofitable.[10/]

A shift in the Court's view with respect to conglomerate mergers has also occurred. The Procter and Gamble (P&G) merger with Clorox was condemned on the ground that P&G was perceived as a potential de novo entrant (and that it would carry on Clorox's business at a lower cost than Clorox could attain on its own). The Court has since added restrictions on the use of the perceived potential entrant doctrine and it has eliminated efficiency as a basis for condemning mergers. In U.S. v. Marine Bank corporation, it said

> . . . a market extension merger may be unlawful if the target market is substantially concentrated, if the acquiring firm has the characteristics, capabilities, and economic incentive to render it a perceived potential de novo entrant, and if the acquiring firm's premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market.[11/]

The Court's opinion in the P&G case had accepted as fact that the liquid bleach industry was oligopolistic, in spite of the presence of 200 competitors, and had speculated that price competition was not vigorous. It had not found it necessary to determine whether P&G's potential entry

had "in fact tempered oligopolistic behavior." It simply asserted, with no evidence beyond some speculation on its part, that "It is clear that the existence of Procter at the edge of the industry exerted considerable influence on the market." Justice Harlan, in his concurring opinion, disagreed with the majority's view that "[t]he anticompetitive effects with which this product-extension merger is fraught can easily be seen." He went on to say that "assumption is no substitute for reasonable probability." And he indicated that there was no support for the proposition that there was "a reasonable probability that Procter would have entered this market on its own."

In light of the Court's shift in its tests for legality of conglomerate mergers, the new guidelines should not suggest that such mergers will be challenged solely on the ground that a potential entrant is acquiring a firm with a share greater than 25 percent of some market or greater than 10 percent in a highly concentrated market, as the 1968 guidelines do (see Appendix).

Conclusion

Mergers and acquisitions facilitate "the reallocation of resources and the adapt[ation] of firm sizes and market structures to changes in relative demands, technology, and competitive conditions."[12/] Surges in merger activity are manifestations, and a consequence, of changing circumstances and vigorous competition. If competition were not vigorous, changes in technology, the relative prices of labor and capital, or rates of growth in demand would not cause some firms to expand more rapidly than others and to acquire others. Instead, each would rest comfortably in its market niche, refrain from competing, and accept its share of growth. Firms with apparently widely different efficiencies would quietly coexist. "That the less efficient are able to survive [would be] an indication that competition lacks the vigor which would force them to improve or retire from the field [via merger or liquidation]."[13/]

Since a high level of merger activity is a sign of robust competition and expanding opportunities, the cries of alarm with which surges in merger activity are greeted are simply perverse from the point of view of improving efficiency, spurring growth, and adapting to changing circumstances. Only to the extent that we wish to remain frozen in a tradition bound state

with all the old familiar places, businesses, and occupations forever with us and progress abolished should we adopt any merger policy other than one of neutrality, neither encouraging nor discouraging the activity. Perhaps the possibility of temporary monopoly may be a reason for discouraging horizontal mergers encompassing more than 50 percent of an industry's capacity in times when there is no excess capacity in the industry, but there is no reason for discouraging conglomerate or vertical mergers.

Instead of being alarmed by a high volume of mergers, we should be alarmed by the opposite. "[L]ow merger rates may . . . be cause for concern. For low merger activity . . . may indicate that competition lacks the vigor which would compel rapid adjustment to changing market conditions."[14/]

Appendix

THE MERGER GUIDELINES

In 1968, the Antitrust Division issued merger guidelines "to acquaint the business community, the legal profession, and other interested groups and individuals with the standards currently being applied by the Department of Justice in determining whether to challenge corporate acquisitions and mergers."[1/] The standards laid down consisted of market share measures based on "structuralist" doctrines (see table 16).

The Department's 1968 statement laid down rules concerning three classes of mergers--horizontal, vertical, and conglomerate. In the case of horizontal mergers, the statement distinguished between "highly concentrated" and "less highly concentrated" markets. The standards for allowable mergers were stricter in highly concentrated markets than in those less concentrated. In the former, a merger of a firm selling more than 15 percent of the product in a market with one selling more than 1 percent would ordinarily be challenged, said the Department of Justice. In the latter, a merger of a firm selling 25 percent or more of a product with one selling 1 percent or more would be challenged (see table 16).

A vertical merger joining a firm supplying 10 percent or more of some input to a market with a firm purchasing more than 6 percent of the material or service supplied in that market would also be challenged, according to the guidelines. In the case of conglomerate mergers, the transaction would be challenged if the acquired firm sold more than 10 to 25 percent

of the product in its market, the exact figure depending upon the acquired firm's sales rank and the level of concentration in its market (see table 16).

Table 16

Department of Justice 1968 Merger Guidelines

HORIZONTAL MERGERS

(1) Where the leading four-firm share of business is 75 percent or more, a merger will ordinarily be challenged if the firms involved possess the following market shares:

Acquiring Firm	Acquired Firm
4% or more	4% or more
10% or more	2% or more
15% or more	1% or more

(2) Where the concentration ratio is less than 75, a merger will ordinarily be challenged if the firms involved possess the following market shares:

Acquiring Firm	Acquired Firm
5% or more	5% or more
10% or more	4% or more
15% or more	3% or more
20% or more	2% or more
25% or more	1% or more

(3) Other mergers may be challenged where the acquired firm has 2% or more of the market, if the acquiring firm is among the eight largest in that market and the market share of any grouping of the two to eight largest firms has increased 7% or more in the preceding ten years.

VERTICAL MERGERS

(1) Mergers will ordinarily be challenged where the firm supplying inputs accounts for 10% or more of sales in its market and the purchasing firm accounts for 6% or more of the purchases in the same market.

(2) Other mergers may be challenged outside of the above limits if there is a significant trend toward vertical integration by merger.

CONGLOMERATE MERGERS

(1) Merger by a potential entrant into a market will ordinarily be challenged where: (a) the acquired firm has 25% or more of the market; (b) the acquired firm is one of the two largest in the market and the top two have 50% or more of the market; (c) the acquired firm is one of the four largest in a market in which the top eight have 75% of the market and the acquired firm at least 10%; (d) the acquired firm is one of the largest eight in a market where the largest eight have 75% or more of the market.

(2) Mergers will ordinarily be challenged which create a significant danger of reciprocal buying.

(3) Acquisition of a leading firm may be challenged where the acquisition may increase that firm's market power, raise barriers to entry, or produce a very large disparity in size.

(4) Other conglomerate mergers that on specific analysis appear anticompetitive.

Source: "Merger Guidelines," U.S. Department of Justice, May 30, 1968, Journal of Reprints for Antitrust Law and Economics, vol. 1 (Summer 1969), pp. 181-200.

The Supreme Court has rejected the use of mechanical formulae for determining the illegality of horizontal mergers, notably in General Dynamics in 1974 as well as in other cases, although it once leaned in that direction.[2/] Also, several leading industrial organization scholars have, in recent years, disavowed their former views favoring the use of structural tests.[3/] The old thesis that structure determines conduct and performance has come under strong attack and this paradigm has been stood on its head. The modern view has come to regard performance and conduct as more likely to determine structure than the reverse, and empirical support for this view has been accumulating.[4/]

The probability that vertical mergers would or could have anticompetitive effects has been taken seriously by few economists[5/] and that conglomerate mergers would or could have such effects has never been widely believed by students of industrial organization. With the growth in the body of research on the causes and effects of industrial concentration together with work in the last decade on vertical and conglomerate mergers, as well as the changes in the Court's understanding of what type of mergers are anticompetitive and the Antitrust Division's selection of cases,[6/] the merger guidelines have become obsolete.

The Antitrust Division is nov engaged in reformulating its guidelines concerning the mergers that are likely to be challenged in the enforcement of section seven of the Clayton Act. Apparently, there will be only two categories of analysis instead of the present three. There will be horizontal mergers and other mergers. The present head of the Antitrust Division regards the 1968 vertical guidelines as "conceptually unsound from the

first to the last word."[7] Other mergers will be viewed in terms of their horizontal effects. The question of their horizontal effects will turn largely on the concept of "potential entry." This will be a "more dominant consideration" than it is in the existing guideline statement.[8]

NOTE: The Committee has placed the 29 pages of footnotes that accompany this statement in the hearing file in an effort to reduce printing expense.

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